INCOME-TAX

(FOR COMMERCE & LAW STUDENTS)

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In loving memory of my son

HAR SARAN

who died on 8th October 1942 while in his nineteenth year

PREFACE TO SIXTH EDITION

It is very encouraging to find that the fifth edition of this book has been sold out in a year's time.

In preparing this edition the whole text has been completely revised in accordance with the changes made in the Income-Tax law of India in 1948.

Nawalgarh :
1st August 1948.

R. R. G

PREFACE TO FOURTH EDITION

For this edition the book has been entirely rewritten and considerably enlarged. It now embodies all the up-to-date amendments made in the Income-Tax law of India. Particular care has been taken to explain and illustrate the points (*e.g*: Indian State Income) that cause confusion and difficulty to students.

As the book is intended primarily for the use of students preparing for the B. Com., M. Com., LL.B., R.A. Final & Income-Tax Departmental Examinations, a large number of difficult questions taken from the question papers set at these examinations have been included as worked out examples.

It is now confidently hoped that the book will admirably meet the requirements of those students who have to study Income-Tax for any examination.

Nawalgarh (Jaipur)
1st May 1946.

R.R.G.

PREFACE TO FIRST EDITION

Students, who study Advanced Accountancy for the B. Com. Degree Examination of the various Indian Universities and the Registered Accountant's Final Examinations conducted by the Central Government under the Auditor's Certificate Rules, are usually required to possess a working knowledge of the Indian Income-tax Law in relation to accounts.

The purpose of writing this book is, therefore, to place at the disposal of advanced accountancy students a summary of the Income-Tax Law of India (as amended up to date) in an easily understandable form illustrated through out with numerous examples. Some of the intricate provisions of Law, such as those relating to Double Taxation Relief, with which accountancy students cannot be expected to be familiar, have been omitted.

It is my pleasant duty to acknowledge with gratitude the assistance that I have received from the following books.—The Income-Tax Manual, 8th Edition ; The Law of Income-Tax in India by V. S. Sundaram, 5th Edition ; The Income. Tax Act by A. B. Aiyar ; and the Main Provisions of Indian Income-Tax Act, 1939 published by the Times of India Press, Bombay.

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R. R. G.

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CHAPTER 1.

INTRODUCTION

Income-tax, as its very name implies, should be a tax on income and not on capital; but in India income-tax is levied not only on income but also on capital gains. The law does not define income, although it specifies certain kinds of receipts that are to be included in or to be excluded from it. Therefore with regard to income that is to be taxed, guidance is to be sought from judicial pronouncements which in their turn are largely based on commercial usage.

Income denotes a periodical monetary return coming in with some sort of regularity or expected regularity from definite sources. Capital is a fund and income a flow, capital is like a tree and income is in the nature of its fruit.

The Act. The law of income-tax is contained in the Indian Income-tax Act of 1922 (as amended up to date). Income-tax was introduced in British India in the year 1860. The Income-tax Act of 1922 extends to the whole of British India, and applies also, within the Indian States, to British subjects in those states, who are in the service of Government or of a local authority.

The Act relates both to income-tax and super-tax. It deals merely with the basis, the methods, and the machinery of assessment. It does not contain a schedule of rates at which tax is to be charged. These rates of tax are determined by the Finance Act which is passed annually by the Central Legislature in the month of March.

Tax is levied for each financial year on the income of the previous year, which is both the basis and the measure of taxation. Hence no assessment is made in the first year in which a business is started; but the first assessment is made, after the close of the assessee's first accounting period, on the profits of that period.

Definitions

Section 2 defines a number of terms used in the Act, and the following are the principal definitions :—

1. Agricultural Income. This is income derived from land which is (i) used for agricultural purposes, and is (ii) either assessed to land revenue in British India or is subject to a local rate assessed and collected by an authority in British India. Any income from land which does not satisfy these two conditions is not agricultural income. The following are examples of agricultural and non-agricultural income :—

Income which is agricultural. Income received by a land owner from the sale of timber or leaf grown on his own land. Land revenue assigned to a *jagirdar*. Interest on arrears of rent of land used for agricultural purposes unless the arrears are secured by a bond and are, therefore, recoverable by a civil suit. Income derived from pasturage.

Income which is non agricultural. Profits from contracts taken for the cutting down and selling of timber. *Nazars* paid by tenants of agricultural holdings at the beginning of the zamindari year. *Nazars* for petitions presented to the zamindars for dealing with questions of succession, settlement and partition. The profits of sugar and tea factories. Income derived from

the manufacture of salt. Interest on pro-notes and bonds executed for arrears of rent. Income from markets, fisheries and ferries. Income from supply of water for irrigation purposes. Income from stone quarries. Income from royalty from a colliery. Income derived from the working of brick kilns or brick fields. Rent from land used for potteries.

Income which is partly agricultural and partly non-agricultural.

(a) Income derived from the sale of tea grown and manufactured by the seller in British India is computed as if it were income derived from business, but only 40 per cent. of such income is deemed to be income *liable* to tax: that is 60 per cent. of such income is treated as agricultural income.

But in computing such income an allowance is to be made in respect of the cost of planting bushes in replacement of those that have died or become permanently useless in a area already planted, and also in respect of the upkeep of extensions of the estate which are not in bearing. No capital expenditure in connection with such extensions is, however, admissible.

(b) Income derived in part from agriculture and in part from business, such as in the case of a sugar mill company owning its own agricultural farm. In such a case in determining that part which is chargeable to income-tax under the head "Business," the market value of any agricultural produce which has been raised by the assessee or received by him as rent in kind and which has been utilised as raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted, and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

For this purpose the 'market value' means *either (a)* where the agricultural produce is sold in the market, the value calculated according to the average price at which it has been so sold during the year previous to that in which the assessment is made: *or (b)* where the agricultural produce is not ordinarily sold in the market in its raw state, the cost of production plus a reasonable rate of profit as determined by the I. T. O.

2. **Assessee.**—An assessee is a person by whom tax is payable. The executor, administrator or other legal representative of a deceased person is treated for the purpose of an assessment on the income of such deceased person, as an assessee. If any person who is required to deduct tax does not deduct it, or after deducting it fails to pay it to Government, then he is deemed to be an assessee in default in respect of such tax.

3. **Company.**—The term 'company' means any incorporated, chartered or statutory company and a company incorporated in any other British territory or in an Indian State. It also includes any foreign association carrying on business in British India (whether incorporated or not) which has been declared to be a company by the Central Board of Revenue.

The term 'Indian Company' means a company as defined in the Indian Companies Act of 1913, the registered office of which is situated in British India.

4. **Dividend.**—This term includes :—

(a) Any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company.

The undistributed profits of a company may be distributed to the shareholders in any of the following ways :—(i) in cash or in the shape of some other assets ; (ii) in the shape of bonus shares of the company ; (iii) in the shape of shares or debentures of another company ; (iv) in the shape of deposit certificates or deferred dividend warrants.

(i) In this case there is no doubt that it is a distribution of profits entailing a release of the assets of the company, and such distribution would clearly be a dividend.

(ii) When bonus shares are issued, there is no release of the company's assets. Hence they are not liable to taxation in the hands of the shareholders, until they are actually paid off by the company during its life-time or in liquidation.

(iii) Profit distributed in the shape of shares or debentures of another company are included in the term dividend and are liable to taxation in the hands of the shareholders, because there is a release of the assets of the company, i. e., distribution of the company's investments.

(iv) The distribution of profits by issuing deposit certificates or deferred dividend warrants is included in dividend and is taxable in the hands of the shareholders, because these are in the nature of debentures and are covered by revenue profits.

(b) Bonus debentures if they are covered by accumulated profits in the hands of the company.

(c) Any distribution made to the shareholders of a company out of accumulated profits of the company on the liquidation, if such profits arose within six years of the liquidation. But a distribution made out of profits earned during the liquidation is a capital receipt in the hands of a shareholder and is therefore not taxable.

(d) A distribution on reduction of capital to the extent of accumulated profits which arose after the previous year preceding 1st April 1933, the object of this being to prevent distribution of profits in the guise of reduction of capital in order to avoid tax.

Notes - (1) The (c) and (d) do not apply to the holders of preference shares which have been issued for full cash consideration, and which are not entitled in the event of liquidation to participate in the surplus assets of the company.

(2) The term 'accumulated profits' wherever it occurs above does not include capital gains of any previous year prior to the previous year for the assessment year 1946–48.

5. **Income.** Section 2 (6C) does not define income, but widens the accepted meaning of the term so as to include in it the following receipts which cannot strictly be called income :—

(a) Anything falling within the definition of dividend ;

(b) A lump sum received by an employee for past services or from an unrecognised provident fund, which is deemed to be part of his salary ;

(c) A profit on the sale of plant, machinery or furniture ;

(d) Any capital gains chargeable to tax under section 12B ; and

(e) The profit of a mutual insurance association.

6. **Person.** A person includes any company, association of individuals whether incorporated or not. Hindu undivided family and a local authority.

7. **Previous year.**—As already stated tax is payable by an assessee in respect of his total income of the 'previous year'; therefore the definition of this term is very important. The provisions of the law regarding this term are :—

(1) The previous year means the twelve months ending on the 31st day of March immediately preceding the financial year for which the assessment is to be made.

(2) But where the accounts of an assessee have been made up to a date within the said twelve months in respect of a year ending on any date other than the 31st March, the assessee can adopt that accounting year as his previous year, e. g., Diwali year, Dasehra year, Samvat year, etc.

(3) An assessee is allowed to have a separate previous year for each separate source of income. Separate businesses are treated as separate sources of income.

(4) In the case of a new business, the previous year is the period from the date of the setting up of the business to the 31st March next following, or, at the option of the assessee, to his accounting date.

(5) The previous year of a partner in respect of his share of the firm's income is the same as the previous year of the firm.

(6) When the assessee has once adopted a particular accounting year as his previous year in respect of a certain source of income, he cannot change it except with the consent of the I. T. O. and on such conditions as the latter may impose.

The Central Board of Revenue has authorised the Commissioner of Income-Tax in each province to determine as the "previous year" in the case of any assessee :—

(a) a commercial year which may consist of more or less than 12 months, provided that no commercial year which extended to less than 11 months or more than 13 calendar months in any one year shall be so determined ; and

(b) a commercial year terminating after the end of the previous financial year, provided that no commercial year terminating later than one month after the end of the previous financial year shall be so determined.

Special provision is made for the case of a business, profession or vocation newly set up in the financial year preceding the year for which the assessment is to be made. In such a case the previous year is the period from the date of the setting up of the business to 31st March next following, or if the accounts of the assessee are made up to some other date than the 31st March, then at the option of the assessee the period from the date of the setting up of the business to this other date. If, however, this other date does not fall between the setting up of the business and the next following 31st March, it will be deemed that there is no previous year. Thus if a business is set up on 1st June 1946 and the accounts are made up to the 31st May 1947, the assessee can elect to have the year ended 31st May as his previous year, and in such circumstances there will be no previous year for the 1947-48 assessment year, the profits for the year ended 31st May 1947 being assessed in the 1948-49 assessment year.

Exceptions. The following are the exceptions to the rule that the tax is charged on the income of the previous year ; that is to say, in these cases the income of a year may be assessed to tax in the same year :—

(a) Section 24 A when a person is likely to leave British India for good.

(b) Section 25 when a business, profession or vocation is discontinued.

(c) Section 44A and 44B in respect of the income of certain classes of shipping.

Income-Tax Authorities

The various authorities entrusted with the work of administering the law of income-tax in India are as follows :—

1. **Central Board of Revenue.** This Board consists of two members and is appointed by the Central Government to control government revenue from income-tax, super-tax, excise, customs, etc. One member of the Board is in charge of the income-tax department for the whole of British India. He is the head of that department ; and it is on his recommendation that the Central Government makes the appointments of Commissioners, Assistant Commissioners and Income-Tax Officers. The Board cannot, however, interfere with the appellate functions of Appellate Assistant Commissioners of Income-Tax.

2. **Commissioner of Income-Tax.** The head of the Income-Tax Department of a province or other area entrusted to him is the Commissioner of Income-Tax, who is appointed by the Central Government. The specific powers conferred upon the Commissioner in regard to income-tax proceedings are given in the various sections of the Income-Tax Act. He has the general control of the income-tax administration in the area under his charge.

3. **Appellate Assistant Commissioner of Income-Tax.** He is under the direct control of Central Board of Revenue, and his function is to hear appeals from the orders of the Income-Tax Officers.

4. **Inspecting Assistant Commissioner of Income-Tax.** He is under the control of the Commissioner and his function is to supervise the work of the Income-Tax Officers in his jurisdiction. In certain cases his permission is necessary before an Income-Tax Officer can impose a penalty on or start a prosecution of an assessee.

5. **Income-Tax Officer.** He is the actual assessor. He makes the assesment, demands the tax from the assessee, and recovers it from him. When an Income-tax Officer is promoted as Appellate Assistant Commissioner, he cannot hear appeal against his own order as I. T. O. which are dealt with by another Appellate Assistant Commissioner.

6. **Appellate Tribunal.** This is the highest appellate authority which began to function from 25th January 1941. The Tribunal is appointed by the Central Government ; and it consists of an equal number of judicial members and accountant members, the total being not more than ten in all. A judicial member is to be the president of the Tribunal. Each Bench of the Tribunal consists of two members, one of whom is a lawyer and the other an accountant. Each Bench hears appeals in a different part of the country. In the case of important appeals, and also where two members of a bench disagree between themselves, a Bench of three members is formed by the president of the Tribunal. The Tribunal's order on questions of fact is final. If, however, the assessee disagrees with the Tribunal's decision of questions of law, he can ask the Tribunal to refer the said question to the High Court.

Test Questions

1. Explain clearly the meaning of the term 'Dividend' as defined in the Indian Income-Tax Act. *(Agra M. Com. 1947)*

2. What do you understand by the term 'Income'? Would the dividend of a company distributed in the form of a fully-paid share be treated as income? *(Agra LL. B. 1947)*

3. Under section 3 of the Indian Income-Tax Act, assessment for any year is to be made on the income, profits and gains of the previous year. Are there any exceptions to this rule? If so what? *(Agra. M. Com 1946)*

4, Explain fully the term 'Previous Year'.

5. A person set up a new business on 1st August 1945. Up to the time of assessment he had not made up his accounts.

If his assessment were taken up in June 1946 and he urged that he would close his accounts for the first year on 31st July, would you concede his request and, if so, why?

If his assessment were taken up in September 1946 and he urged that he wanted to adopt the year ending 31st July 1946 as his previous year, would you concede his request, and, if so, why? *(Income-Tax Departmental Exam. 1946)*

CHAPTER 2

RESIDENCE AS AFFECTING LIABILITY TO TAX

Since the liability of a person to tax is determined by reference to his residence, the question of assessees' residence is an important one. With regard to residence assessees are divided into three distinct classes :- *(a)* Persons not resident in British India ; *(b)* Persons resident but not ordinarily resident in British India ; and *(c)* Persons resident and ordinarily resident in British India. Each of these three classes is chargeable to tax on a different basis, and these classes are defined as follows :—

1. Individuals

An individual falls outside the first class, that is to say, he is classed as *resident* in British India, if he

(i) is in British India for one hundred and eighty-two days or more during the year ; *or*

(ii) maintains a dwelling house in British India for one hundered and eight two days or more, and is in British India during the year any period however short ; *or*

(iii) is in British India for any time, however short, during the year (other than on a casual visit) and has been in British India for periods amounting in all to 365 days or more in the four preceding years ; *or*

(iv) is in British India for any time in that year and the I. T. O. is satisfied that such individual having arrived in British India during that year is likely to remain in British India for not less than three years from the date of the arrival.

Therefore if an individual does not satisfy any of these four conditions he is ***non-resident***. But if he is resident by reason of any of these conditions applying to him, ***he is classed as resident but not ordinarily resident***, unless he satisfies both of the following two further conditions, which would make him ***resident and ordinarily resident*** :—

(i) That he has been resident (as defined above) in at least 9 out of the 10 preceding years ; *and*

(ii) That he has been in British India for periods amounting in all to more than two years during the 7 preceding years.

2. Companies, firms and Hindu undivided families

A company is ***resident*** in British India if the control and management of its affairs is ***wholly*** in British India or if more than half its income (exclusive of any taxable capital gains) arises in British India. It is ***ordinarily resident*** where it is resident.

For the purpose of comparing the two incomes, it is only the income that actually arises in either place that is required to be taken into account and not any income which may be received, or be deemed to arise. If an income is received in British India from foreign parts or *vice versa*, such income shall in the calculation have to be regarded arising in the place of its origin and shall have to be excluded from the computation of income in the country of its receipt. Next the whole of the income in British India including

agricultural income and any other income which may be exempt from tax has to be taken into account, in determining whether more than half of the income of a company arise in British India.

A Hindu undivided family is *resident* in British India unless the control and management of its affairs is situated wholly without British India. It is *ordinarily resident* in British India if its manager is ordinarily resident here.

A firm or other association of persons is *resident* in British India unless the control and management of its affairs is situated wholly without British India. Also it is *ordinarily resident* in British India, if it is resident here.

Illustrations

1. A person after about 25 years in British India retired to England in April 1937 and returned to British India in February 1940 to take up a salaried appointment.

In 1939-40 he was not here for 182 days nor did he have a house here. But during the four preceding years (1935-36 to 1938-39) he was here for more than 365 days and he did not come back on a casual visit. So he is a resident for 1939-40,

Again he is resident for nine out of the preceding ten years (1929-30 to 1938-39) and he was also here for more than two years during the preceding seven years (1932-33 to 1938-39.)

Therefore for 1939-40 he is resident and ordinarily resident.

2. With reference to the above illustration suppose that he retired to England in march 1937 instead of in April 1937, other facts being the same.

For 1939-40 he would be resident but not ordinarily resident, because he is not resident for nine out of the ten preceding years. This shows how significant a month April is.

Note. In order to determine the residence of an individual for any year, his comings and goings for the ten preceding years must be known. If he is non-resident for two years he cannot be resident and ordinarily resident because a little lump of non-residence leavens a big lump of residence.

3. A Sindhi merchant, trading in East Africa, has no ancestral home in British India, but he visits British India for about two months every two or three years.

He is non-resident.

4. An Indian merchant trading in Africa maintains an ancestral home in British India, but he visits regularly for about two months each year.

He is resident but not ordinarily resident, because he has not during the preceding seven years been in British India for more than two years.

5. *B* came to British India six years ago, and three years ago he went to England on leave for 4 months.

He is resident but not ordinarily resident, because he has not been resident for 9 out of the 10 preceding years.

6. An European member of the I. C. S. first came to British India 15 years ago and three years ago he spent 15 months' leave out of India.

He is resident and ordinarily resident.

7. An Indian who maintains an ancestral home in British India is employed by an Indian State Government. He visits his home in British India for about two months every year.

He is a resident but not ordinarily resident.

8. A British trader who has been in British India for twenty years goes home to the U. K. for five months every year during the hot weather.

He is resident and ordinarily resident.

Incidence of Taxation

1. **A non-resident** is chargeable on all income accruing, arising or received in British India ; but he is not liable to pay tax on his income arising outside British India, whether or not he remits it to British India. But if he remits it to his wife resident in British India she would be taxable on the amount so received by her.

2. **A person resident but not ordinarily resident** pays tax on *(i)* all income accruing, arising or received in British India, *(ii)* any income arising without British India if it is brought into British India, and *(iii)* any unremitted foreign income (in excess of Rs. 4,500) arising from a business controlled in or a profession set up in India including Indian States (except any income accruing or arising in an Indian State which is to be included in total income for purposes of determining the average rate of tax, but is otherwise exempt).

3. **A person resident and ordinarily resident** has to pay tax on *(i)* all income accruing, arising or received in British India, *(ii)* any income arising without British India if it is brought into British India, and *(iii)* all unremitted foreign income in excess of Rs. 4,500 (except any income accruing or arising in an Indian State which is to be included in total income for purposes of determining the average rate of tax, but is otherwise exempt).

Under an important proviso a sum of Rs. 4,500 is to be deducted from the income arising abroad in the previous year but not brought into British India. The proviso is applicable to persons resident in British India whether they are ordinarily resident or not. It should be noted that income from agriculture arising or accruing outside British India is not exempt from tax, but such income accruing or arising in an Indian State is liable only if it is received or brought into British India by or on behalf of the assessee who is resident. In the case of a person who is also ordinarily resident it is to be included in his total income, but is otherwise exempt. In the case of a person not resident in British India it is to be included in his 'total world income.'

Illustration

Suppose an assessee's income for the previous year consisted of the following :—

(a) Rs. 10,000 earned in British India ;

(b) Rs. 12,000 earned in Iran from property and investments, of which Rs. 5.000 was remitted to British India ;

(c) Rs. 9,000 earned in Africa from a profession controlled in India, of which Rs. 4,000 was brought into British India ; and

(d) Rs. 9,000 earned from salary in Jaipur State, of which Rs. 3,000 was brought into British India.

On how much income will he be required to pay tax, if he is *(a)* an ordinary resident, *(b)* a resident not ordinarily resident, and *(c)* a non-resident ?

(a) As an *ordinary resident*, he will pay tax on Rs. 29,500 at the rate applicable to Rs. 35,500, thus :

		Rs.
British Indian income	...	10,000
Remitted foreign income	...	12,000
Unremitted foreign income earned in Iran and Africa in excess of Rs. 4,500	...	7,500
Unremitted Indian State income included for rate purposes)	...	6,000
	Total Income	35,500

(b) As a *resident not ordinarily resident*, he will pay tax on Rs. 22,500 at the rate applicable to Rs. 28,500, thus :

		Rs.
British Indian income	...	10,000
Remitted foreign income	...	12,000
Unremitted African income arising from a profession controlled from India in excess of Rs. 4,500	...	500
	Total Income	22,500

(c) As a non-resident, he will pay tax on his British Indian income, namely, Rs. 10,000.

Status for each year and for each source of income. The residential qualification of an assessee is one to be determined each year with reference to the previous year. The assessee's qualification may change from year to year. In one year he may be a resident; in the next year, non-resident. What is material is his status during the *previous year*, and not during the tax year.

As already stated in Chapter 1, an assessee is entitled to have separate previous years in respect of each of his sources of income. Therefore the status of an assessee in the assessment for one and the same tax year may vary with reference to his several sources of income.

For example, the previous year of an assessee is the year ending 30th September for his cotton ginning factory, and it is the calendar year for his money-lending business, both businesses being in British India. If he came for the first time to British India on 1st June 1946 and went back to his home in an Indian State on 31st January 1947, then, for the 1947-48 assessment year, he is a non-resident for his cotton ginning factory income and a resident not ordinarily resident for his money-lending business.

Test Questions

1. The Indian Income-Tax Act has divided the tax-payers into three distinct categories, viz—*(a)* resident and ordinarily resident in British India, *(b)* resident but not ordinarily resident in British India, and *(c)* not resident in British India. Explain fully the basis of determining the above in the case of an individual, firm, Hindu undivided family and company, and point out the difference in their tax liability. *(Agra M. Com. 1945)*

2. What is the difference between the conditions governing the residence of a firm and that of a company?

3. A branch manager of a company having its head office in Calcutta was transferred in August 1937 from Rangoon to Calcutta. At the time of

his assessment for 1940-41 he stated before the I. T. O. that he was in Calcutta from 1926-27 to 1933-34 (both years inclusive) and from 1st April 1934 up to the time of his transfer he was in Rangoon.

He had an income of Rs. 5,000 from property and Rs. 10,000 from interest on deposits in Rangoon which was not received in British India and was therefore claimed to be not taxable. The I. T. O. accordingly assessed him on salary only actually received for ten months of the previous year. Was the assessment correct ? If not, give your reasons.

4. What is the difference between a resident and a non-resident as regards the incidence of taxation ?

5. A firm resident in British India obtained a lease of agricultural land in an Indian State and brought its produce to British India where it was sold in its raw state. It is claimed that the profit arising from the sale is not taxable, because (1) it is agricultural income, and (2) it actually arose in the State where the cultivation was done. State how you would deal with the case and give reasons for your answer. *(Agra M. Com. 1947)*

6. A Hindu undivided family had no business in British India but for the education of his children the karta of the family had been maintaining a house in British India since 1930. He dies in 1943 and for one year no member of the family resided in British India. In 1944 the then karta of the family came to British India and started some business. What would be the status of the family for 1946-47 assessment and why ? If the only other income of the family were agricultural income of Rs. 8,000 in an Indian State which is not brought into British India, how would this income affect the assessment ? *(Income-Tax Departmental Exam. 1946)*

7. Explain, by illustrations, what you understand by an individual being *(a)* resident and *(b)* not ordinarily resident. *(Agra M. Com. 1948)*

CHAPTER 3.

EXEMPTIONS

(1)

Incomes exempt from tax (both income-tax and super-tax) and not to be inculded in the total income.

1. *Income of property held under trust or legal obligation for religious or charitable purposes.* If the property is held wholly for religious or charitable purposes the whole income is exempt ; but where the property is held in trust in part only for a religious or charitable purpose, the exemption can be claimed only in respect of so much income as has been either actually applied or finally set apart for such purpose.

'Property' may include securities, a business or a share in a Business: 'other legal obligation' includes Moslem wakfs and Hindu endowments ; and 'charitable purpose' is defined to include relief of the poor, education, medical relief, and the advancement of any other object of general public utility.

2. *Income from business carried on by a charitable or religious trust.* The income derived from business carried on on behalf of a religious or charitable institution is exempt when it is applied solely to the purposes of the institution and *either* the business is carried on in the course of the carrying out of a primary purpose of the institution *or* the work in connection with the business is mainly carried on by beneficiaries. Thus an orphanage would be exempt in respect of the business of selling products made by the inmates of the institution ; but if a religious body decided to augment its income by carrying on a regular trade in the open market in competition with ordinary traders, it profits from such business would be taxable.

3. *Voluntary contributions received by a charity.* The income of a religious or charitable institution derived from voluntary contributions is exempt if it is applicable to religious or charitable purposes.

NOTE.—These three exemptions granted to religious and charitable bodies are restricted to those charities which are for the benefit of the public. A private religious trust is not exempt : and in the case of one which is partly private and partly public only that part of the income, which can be said to enure to the benefit of the public, is exempted.

4. *Income of local authorities.* The profits made by a local authority from the supply of commodities or services outside its jurisdictional area are however taxable.

5. *Interest on securities held by an official or semi-official provident fund.* This exemption applies only to provident funds to which the Indian Provident Funds Act of 1925 applies and the term securities includes all trustee securities. Any capital gains arising from the sale, exchange or transfer of such securities are also exempt.

6. *Capital sums received in commutation of pension, consolidated compensation for death or injuries, etc.* This clause was deleted by the Amendment Act of 1939, as being unnecessary. But there is a clear pronouncement of the Judicial Committee that these kinds of receipts cannot be treated as income in any scheme of taxation.

The 'injuries' referred to are only personal injuries and not injuries to proprietory or contractual rights. Though commutation of pension is exempt, gratuities in lieu of pension are taxable.

7. *Special allowance to meet expenses of the duties of an office or employment.* Two conditions have to be satisfied before this exemption can apply: (i) The expenses incurred by the employee must be wholly and necessarily incurred in the performance of his duties as an employee, and (ii) the allowance or perquisite must have been granted by the employer with the said purpose of meeting the extra expense thus caused to the employee, e. g., travelling allowance.

8. *Casual income.* This is an important class of income which is to be excluded in computing the total income of an assessee. In order to be exempt the income must comply with three conditions: (i) It does not arise from business, profession, vocation or employment; (ii) it is of a casual and non-recurring nature; and (iii) it is not a capital gain chargeable to tax under section 12 B. *All these conditions must be fulfilled.* It is important to note that certain receipts may be isolated and yet may not be of casual and non-recurring nature. The following are examples :—

(1) A purchases a house with a view to reselling it at a profit. His profit from this transaction is taxable, although it is an isolated one.
(2) B purchases a house for his own residence and later on sells it at a profit. His profit is also taxable under certain conditions (see Chapter 8).
(3) A wins a prize in a lottery. This income is not taxable.
(4) B is a book-maker. His profit from betting is taxable.
(5) C is a professional beggar. His income from mendicancy is taxable.
(6) D makes a practice of speculating in shares. His profit therefrom is taxable.
(7) A writes a book. His income from this source is taxable.
(8) Lump sum legacies are exempt, but annuities granted under a will are taxable.
(9) A sum paid to a merchant who acted as an arbitrator in a dispute among the heirs of a Nawab regarding the division of the estate is a casual receipt and not taxable.
(10) A lawyer advanced a sum of money without any expectation of making a profit to oblige a client and the client agreed to pay 25% of the profits which may accrue to him from certain mining rights purchased by him with the help of the money. The sum received by him is not taxable.
(11) Fees from casual journalistic efforts are not taxable but fees for setting examination papers in his own subject paid to a Professor are taxable.
(12) The yield from Treasury Bills issued at a discount and redeemed at par after four or five months is liable to tax.

9. *Agricultural income.* The income arising from agriculture outside British India is not exempt.

10. *Income of a recognised provident fund.* Under this head the income (including any capital gains arising from the sale, exchange or transfer of capital assets) received by the trustees of a recognised provident fund is exempt.

11. *Any income chargeable under the head 'Income from property'* in respect of a building the erection of which is begun and completed between the 1st day of April 1946 and the 31st day of March 1950 (both days inclusive), for a period of two years from the date of such erection. This provision applies to buildings which are not used by the owner for the purposes of his business.

12. *Share of income from a Hindu undivided family.* Under section 14 (1) this is to be ignored in assessing the individual members of the family in respect of their separate income, provided it is received out of the income of the family.

13. *Income of an approved superannuation fund.* The income of such a fund (including any capital gains arising from capital assets) is exempted under section 58 R.

14. The yield of post office cash certificates and national savings certificates.

15. The interest on post office savings bank deposits.

16. The salary and allowance paid by a State in India during the period of deputation to any persons deputed by the State for training in British India.

17. The pensions paid in the United Kingdom or in a Colony to officers of local authorities or employees of companies or of private employers, such officers employees being resident out of India.

(II)

Income included in total income but exempt from both income-tax and super-tax.

1. Income accruing in an Indian State unless it is received or brought into British India or unless it is taxable under section 12-B as a capital gain or unless it is taxable under section 42 by reason of business connection in British India—section 14 (2) (c).

2. The profits of any Co-operative Society other than the Sanikatta Salt owners' Society in the Bombay Presidency for the time being registered under the Co-operative Societies Act, 1912, the Bombay Co-operative Societies Act, 1925, or the Madras Co-operative Societies Act, 1932, or the dividends or other payments received by the members of any such Society out of such profits.

The profit should not however include any income from securities, properties, shares and other sources of income referred to in section 12 of the Act.

(III)

Incomes exempt from income-tax and not from super-tax but to be included in total income.

1. Sums deducted by Government from the salary of a government servant for securing to him a deferred annuity or for making provision for his wife or children, not exceeding *one sixth* of his salary—second proviso to section 7 (1).

2. Interest from tax-free government securities—second and third provisoes to section 8.

3. Share of profits from an unregistered firm or other association of persons on which tax has already been paid by the firm or the association as the case may be—section 14 (2) (a) and (b).

Note :—A non-resident partner's share of profits from a registered firm, which share is taxed in the hands of the firm under the second proviso to section 23 (5) (a), is also to be treated in the same way in connection with the assessment of the non-resident partner.

*4. Premium for insurance on the life of the assessee or on the life of his wife or her husband (or in the case of a Hindu undivided family, on the life of any male member or his wife) provided the annual premium does not exceed ten per cent. of the sum insured exclusive of any bonus additions—section 15 (1).

*5. Contribution made by an employee to a provident fund to which the Indian Provident Funds Act of 1925 applies—section 15 (1).

*6. Contributions to a recognised provident fund (made by both the employee and the employer) provided the amount is not more than *one-sixth* of the employee's salary for the year or Rs. 6,000 whichever is less—section 58F (1). The salary for the year means salary as such but not including any other benefits which are included in the taxable income from salary, e. g., the money value of a rent-free house.

7. Interest credited on the accumulated balance of an employee in a recognised provident fund, provided it does not exceed *one-third* of the employee's salary for the year and the prescribed rate of interest (which is at present 6 per cent. per annum)—section 58F (2).

*8. Contribution made by an employee to an approved superannuation fund—section 58R.

9. Sums received by an assessee on account of salary, bonus commission or other remuneration for services rendered, or in lieu of interest on money advanced, to a person for the purposes of his business,

where such sums have been paid out of, or determined with reference to, the profits of such business, and, by reason of such mode of payment or determination, have not been allowed as a deduction but have been included in the profits of the business on which income-tax has been assessed and charged under the head 'business.'

Provided that such sums shall not be exempt from the payment of super-tax unless they are paid to the assessee by a person other than a company and have already been assessed to super-tax.

10. Such part of the profits or gains of a firm which has discontinued its business, profession or vocation as is proportionate to the share of an assessee in the firm at the time of such discontinuance, if income-tax has at any time been charged on such business, profession or vocation under the Indian Income-tax Act of 1918, or if an assessment has been made on the firm in respect of such profits or gains under section 25 (1) of the Indian Income-tax Act, 1922.

Note :—The items marked with an asterisk should not exceed, in the case of an individual, *one-sixth* of his total income or Rs. 6,000 whichever is less, and in the case of a Hindu undivided family, *one-sixth* of its total income or Rs 12,000 whichever is less. And for this purpose the total income of a member of a recognised provident fund should include only his own contribution to the fund (but not his employer's contribution or interest)—proviso to section 58E.

(IV)

Incomes exempt from super-tax, but not from income-tax. So much of the income of any Investment Trust Company as is derived from dividends

paid by any other company which has paid or will pay super-tax in respect of the profits out of which such dividends are paid.

For this purpose an investment trust company is defined as follows :

(i) It is a company having for its principal business the acquisition and holding of investments in the stocks, shares, bonds, debentures or debenture stocks of other companies or in securities issued by public authorities,

(ii) It is not a company formed for the purpose of, or engaged in, acquiring or exercising control over any other company or group of companies or enabling any other persons to acquire or exercise such control,

(iii) It is a company deemed under clause (b) of the Explanation to sub-section (1) of section 23A of the said Act, to be a company in which the public are substantially interested.

(V)

Exemption regarding donations for charitable purposes: No tax is payable by an assessee from the assessment year 1948-49 in respect of any sum paid by him as donations to any institution or fund established in British India for a charitable purpose (which includes relief of the poor, education, medical relief and the advancement of any other object of general public utility) and is approved by the Central Government for this purpose.

This exemption is, however, subject to the following restrictions :—

1. The total amount of the donations paid should not be less than Rs. 250.

2. In the case of a company this exemption is applicable only in respect of income-tax but not super-tax.

3. The aggregate amount of donations should not exceed (a) one-twentieth in the case of a company, and one-tenth in any other case, of the assessee's total income as reduced by any portion thereof exempt from tax, or (b) Rs. 2,50,000, whichever is less.

4. The amount of taxation relief in respect of donations should not in any case exceed half the amount of such donations.

It must, however, be noted that the amount of exempted donations is to be included in the total income of an assessee, and the amount of taxation relief thereon is to be worked out at the average rate of tax.

Test Questions

1. The Indian Income-Tax Act confers absolute exemption in respect of certain incomes while some incomes are included in the total income for determining the rate only.

Explain these provisions fully. *(Agra M. Com. 1947)*

2. What conditions should casual and non-recurring receipts satisfy in order to be exempt from tax. State briefly your reasons why the casual income should or should not be assessed in the following cases :—

(a) A member of a Provincial Legislature receives Rs. 25,000 from a body for helping in the promotion of legislation beneficial to that body ;

(b) In appreciation of his work for A, a lawyer receives an ex-gratia payment of Rs. 5,000 from B for whom he never acted as attorney in any matter.

3. Is there any income that is exempt from both income-tax and super-tax, but which is included in the total income of an assessee for determining the rate of tax applicable to him ?

CHAPTER 4

FOREIGN INCOME

The foreign income of an assessee may be income earned in an Indian State or in countries outside India.

Indian State Income

Section 14 (2) (c) exempts income accruing and arising in an Indian State; and the exemption is applicable only in cases where the income but for the exemption would be included in the total income. In the case of a non-resident, since the income accruing or arising without British India does not form part of his total income (though it does form part of his total world income) the exemption has no application. In the case of a person ordinarily resident it applies in respect of all income accruing or arising in a State but not remitted to British India; and in the case of a person resident but not ordinarily resident it would apply only to the income from a business controlled in or a profession set up in India.

The exemption does not affect the deduction of Rs. 4,500 under the third proviso to section 4 (1), which will be allowed *so as to secure that any other income accruing or arising without British India, which would otherwise be chargeable, is first absorbed.* In other words the statutory allowance of Rs. 4,500 will first be made out of the unremitted foreign income earned in places other than Indian States and then out of the unremitted foreign income earned in Indian States.

The income so exempted is included in the total income for determining the average rate of income-tax and super-tax chargeable on the remaining income.

Whenever any Indian State income, which has already once been taken into account for rate purposes, is brought or received into British India in any subsequent year, that income as well as any other taxable income of that year is to be taxed at the rates applicable *either* to the total income minus the remittance *or* to the remittance itself whichever alternative produces the greater tax.

Illustrations

1. At what rate and on what amount will tax be levied in the following cases assuming that the assessee is ordinarily resident in British India :—

(a) Assessment for 1943–44 :		Rs
Income accruing and arising in British India		25,000
income accruing and arising in a State		25,000
Income accruing and arising in Africa		10,000
	Total	60,000

(b) Assessment for 1944–45 :		
Income accruing and arising in British India		20,000
Income accruing and arising in a State		15,000
Income accruing and arising in Africa		Nil
Indian State income included in 1943–44 assessment on accrual basis but actually received in British India during the previous year		25,000
	Total	60,000

(Agra M. Com. 1946)

Assessment for 1943-44

		Rs
Income in British India	—	25,000
Income in Africa (in excess of Rs. 4,500)	...	5,500
Unremitted income of Indian State	...	25,000
Total Income		55,500

Here tax will be payable on Rs. 30,500 at the rates applicable to the total income of Rs. 55,500.

Assessment for 1944-5

		Rs.
Income in British India	...	20,000
Remitted income of Indian State (already included in 1943-44 assessment for rate purposes)	...	25,000
Unremitted income of Indian state (in excess of Rs. 4,500)	...	10,500
Total Income		55,500

Here tax will be levied on Rs. 45,000 at the rates applicable to Rs. 30,500. For rate purposes there are two alternatives, namely, either total income minus the remittance (Rs. 30,500) or the remittance itself (Rs. 25,000). Obviously the first alternative gives the greater tax. Therefore tax will be charged at the rates applicable to Rs. 30,500.

2. At what rate and on what income tax is leviable in the following cases :—

		Rs.
(a) Assessment year 1942-43 :		
Income accruing or arising in State	...	25,000
Income other than the above	...	20,000
Total		45,000

(b) Assessment year 1943-44		
Income accruing or arising in State included in the 1942-43 assessment for rate purposes but actually received in British India in the previous year	...	25,000
Income accruing or arising in State	...	10,000
British Indian income	...	15,000
Total		50,000

(Income-Tax Departmental Exam, 1945)

For the 1942-43 sssessment tax will be levied on Rs. 20,000 at the rates applicable to Rs. 40,500.

For the 1943-44 assessment tax will be levied on Rs. 40,000 at the rates applicable to Rs. 25,000. For rate purposes there are two alternatives, namely, either total income minus the remittance (Rs. 20,500) or the remittance itself (Rs. 25,000). Obviously the second alternative gives the greater tax. Therefore tax will be charged at the rates applicable to Rs. 25,000.

Losses in Indian States. As stated above, income accruing or arising in an Indian State is exempt unless it is received in British India. It is therefore provided that losses sustained in an Indian State can be set off only against the profits which accrue in an Indian State and which are exempt from tax ; and if they cannot be so set off, they can be carried forward for

six years for being set off against the profits accruing or arising in an Indian State from the same business and exempt from tax,

However, a loss sustained in an Indian State can be set off against the profits accruing or arising in another Indian State in the same assessment, where such profits are not remitted to British India.

Other Foreign Income

In the case of an ordinary resident, all foreign income earned outside British India in places other than Indian States is taxable subject to an allowance of Rs. 4,500. If such income is brought into British India in the year of accrual, it is taxable in full; but if it is brought into British India in a subsequent year it will not be taxed if it has already been taxed in the year of accrual.

Suppose, for example, that in the year ended 31st March 1944 an assessee's income earned in Iran was Rs. 3,500, which was brought in full in British India on 1st June 1946. In preparing his return of income for the previous year ended 31st March 1944, the amount of Rs. 3,500 would be excluded as it is less than the statutory allowance of Rs. 4,500 but it should be included in his return of income for the previous year ended 31st March 1947. Now, if this foreign income be Rs. 27,000 instead of Rs. 3,500, then Rs. 22,500 would be included in the return of income for the previous year ended 31st March 1944, and Rs. 4,500 (Rs. 27,000 minus Rs. 22,500 taxed in an earlier assessment, would be included in his return of income for the previous year ended 31st March 1947.

If the assessee is resident but not ordinarily resident, the unremitted foreign income is excluded from the computation of total income unless it is derived from business controlled in or profession set up in India; but it would be taxable if it is brought into British India in the year of its accrual or in any subsequent year.

If the assessee is a non-resident, the foreign income is included in his total world income for determining the rate of tax applicable to his total British Indian income. If the income is brought into British India in the year of accrual or in any subsequent year it would be excluded from the computation of total income liable to tax in British India.

Where the total income of a non-resident is a loss, it should be carried forward for future set off against his British Indian income, but it should not be set-off against his foreign income, otherwise he would not get any relief in British Indian taxation on account of the loss incurred by him in British India. Should there be any foreign loss of a non-resident, such loss cannot be set off against his British Indian income; but it should be carried forward for being set off against his future foreign income for a maximum period of six years.

Illustration

A company is held to be resident in one year on the footing that its income arising in British India exceeds its income arising in England, and the result is that Rs. 50,000 of its foreign loss is carried forward.

For the next year the company is non-resident since its British Indian income is only Rs. 60,000 as against its English income of Rs. one lakh.

Would the loss carried forward in the preceding assessment be set off against any income? If so, which income assuming that *(a)* the English and the Indian business is one and the same, and *(b)* the English business is different?

(a) When the English and the Indian business is one and the same, the loss of Rs. 50,000 will be set off against the English income, but it can also be set off against the Indian income.

(b) If the English business is different, the loss of Rs. 50,000 can be set off only against the English income.

Test Questions

1. The income accruing or arising in an Indian State has been exempted from income-tax with effect from the assessment year 1942-43. State clearly the nature of this exemption, and point out the difference in the treatment of the income accruing and arising in an Indian State and in other foreign countries.
(Agra M. Com. 1946)

2. A, an ordinary resident of British India, has his business at Agra and a branch in the Jaipur State. For the year ending 31st March 1946, Agra business resulted in a profit of Rs. 30,000, but there was a loss of Rs. 20,000 in the Jaipur Branch. On what income will he pay tax, assuming the Agra and Jaipur businesses to be (i) the same, (ii) different? *Agra M. Com 1947.*

3. An assessee has incurred loss of Rs. 10,000 in an Indian State, but he has made a profit of Rs. 15,000 in another State. He claims that the loss of Rs. 10,000 be deducted from his British Indian income and the profit of Rs. 15,000 should be included only for the purpose of determining the total income. How will you deal with this matter?

CHAPTER 5.

EARNED INCOME

Certain kinds of income, for instance, salary, professional earnings and business profits, are earned through personal exertion. Other kinds of income such as dividends, interest on securities, and income from property are earned without any such exertion. Income falling under the first category involves depreciation of the human machine, and in the system of taxation followed by several countries a lower rate has been fixed or some kind of relief has been given to the tax-payer in respect of this class of income.

The definition of earned income for purposes of taxation contained in section 2 (6 AA) as is follows :—

"Earned income" means any income of an assessee who is an individual, Hindu undivided family, unregistered firm or other association of persons not being a company, a local authority, a registered firm or a firm treated as registered under section 23 (5) (b)

(a) which is chargeable under the head salaries; or

(b) which is chargeable under the head profits and gains of business, profession or vocation where the business, profession or vocation is carried on by the assessee or, in the case of a firm, where the assessee is a partner actively engaged in the conduct of the business, profession or vocation; or

(c) which is chargeable under the head other sources, if it is immediately derived from personal exertion or represents a pension or superannuation or other allowance given to the assessee in respect of his past services or the past services of any deceased person; and includes any such income, which, though it is the income of another person, is included in the assessee's income under the provisions of the Income-Tax Act, but does not include any such income which is exempt from tax under section 14 (2) or under a notification issued under section 60.

On analysing this definition we find that it consists of four things, viz.—

1. It confines the expression to the income of an assessee who is an individual, Hindu undivided family, unregistered firm or other association of persons other than a company, a local authority, a registered firm or a firm treated as a registered firm ;

2. It specifies three main classes of income which fall within the definition, viz.—(a) salaries, (b) profits from business, profession or vocation, and (c) income from other sources provided personal exertion is involved ;

3. It includes within the expression incomes of the above classes of other persons which are included in the assessee's income, e.g., wife's income or minor child's income under section 16 (3) ; and

4. It excludes incomes exempt under section 14 (2), i.e., share of profit from an unregistered firm or other association of persons which has been already taxed and the unremitted Indian State income or under a notification issued under section 60.

Persons to whom earned income relief is admissible. An assessee, who is an individual, Hindu undivided family, unregistered firm or other association of persons, is entitled to the earned income relief.

In the case of a registered firm or a firm treated as a registered firm under section 23 (5) (b), as the tax is not payable by the firm on its own behalf, relief is admissible to the partners by whom tax is payable and who are the assessees. Where a registered firm is assessed, under the second proviso to section 23 (5) (a) in respect of the share of income of a non-resident partner, the earned income allowance appropriate thereto would be admissible in determining the tax payable by the firm on behalf of the non-resident partner provided the partner is actively engaged in the conduct of the business of the firm.

If an unregistered firm is not liable to pay any tax because its income is below the taxable limit, the appropriate earned income allowance in respect of his share of profits of the firm would be admissible to any partner who was actively engaged in the conduct of the business of the firm.

The Indian law does not make any distinction for this purpose between residents and non-residents : vide section 17 (5).

Salaries. All salaries inlcuding pensions or other allowances for past services are entitled to earned income relief. The annual accretion in any year to the balance at the credit of an employee participating in a recognised provident fund, which is included in his total income and which is exempt from income-tax, will be treated as salary for the purpose of computing the earned income allowance. As explained in Chapter 6, the annual accretion consists of the employer's contribution and interest on the employee's provident fund.

Profits and Gains of Business, Profession or Vocation. The income under this head is entitled to earned income relief if the business, profession or vocation is carried on by the assessee himself; in other words where he is actively engaged in business. But the income received by an assessee from a business carried on by a Court of Wards, trustees or a receiver is not entitled to earned income relief, as it is not immediately derived from personal exertion. In such a case profits are earned by persons to whom they do not belong and they belong to individuals who do not earn them. The earned income relief is intended only for assessees who both earn and own the profits.

If an individual is a partner of a firm and is actively engaged in the conduct of the business of the firm, relief is admissible on his share of the profits of the firm and also in respect of the share, if any, of his wife or minor child, which is includible in his assessment under section 16 (3) (a) (i) and (ii), unless the wife or the minor child has been given a share on account of the capital invested in the firm. If the individual is not himself actively engaged in the conduct of the business of the firm, no relief is admissible on his share of profits in the firm or on his wife's or minor child's share in that firm, unless the wife or the minor child is actively engaged in the conduct of the business.

In the case of a Hindu undivided family or an unregistered firm the position is the same as in the case of an individual.

Income from Other Sources. Income falling under this head will be earned income if it is immediately derived from personal exertion, e. g., directors' fees, royalty on books, letting on hire of machinery or plant where the assessee exercises constant supervision and the activity is in the nature of business, underwriting commission, etc.

No earned income allowance is admissible on account of capital gains,

Computation of Earned Income Relief. According to section 15A, the portion of the earned income on which tax is not payable by an assessee in any year is prescribed by the annual Finance Act.

According to the Indian Finance Act of 1948, in making any assessment for the year ending on the 31st March 1949, an amount equal to one-fifth of the earned income shall be deducted from the total income of an assessee provided the amount in no case exceeds Rs. 4,000. It is further provided—

(i) that no income tax is payable on a total income which, before deduction of the allowance of earned income, does not exceed Rs. 3,000 ;

(ii) that income-tax shall in no case exceed half the amount by which the total income (before such deduction) exceeds Rs. 3,000 ;

(iii) that income-tax shall not exceed *either* (a) a sum bearing to half the amount by which the total income (before such deduction) exceeds Rs. 3,000 the same proportion as such reduced total income bears to the unreduced total income, *or* (b) the income-tax payable on the income so reduced at the rates specified, whichever is less.

Note :—earned income relief for the three previous assessment years was as follows :—

1. During the assessment year 1945-46, there was no relief in respect of salaries, and it was 10% in respect of other earned income subject to a maximum of Rs. 2,000.

2. During the assessment year 1946-47 the salaries were entitled to a relief of 10% and the other earned income to a relief of 20% subject to a maximum of Rs. 4,000 in all.

3. During the assessment year 1947-48, it was the same as for 1948-49.

Illustration

If an assessee draws a monthly salary of Rs. 255, what will be his total income, earned income allowance, taxable income, and the amount of tax payable by him for the assessment year 1948-49 ?

			Rs.
Salary being total income	...	...	3,060
Less Earned income allowance	...	...	612
Taxable Income	...	...	2,448

Under the provisions of the Indian Finance Act of 1948, he will have to pay income-tax on Rs. 2,448 according to the ratio of tax payable on his total income of Rs. 3,060.

The tax which is payable on Rs. 3,060 is Rs. 30 being one-half of the excess over Rs. 3,000. Therefore the income-tax payable by him for the assessment year 1948–49 on his taxable income of Rs. 2,448 would be Rs. 24 only (3,060 : 2,448 : : 30 : 24) and not Rs. 59–4–0, because the former amount is less than the latter.

Relief for Insurance, etc. The total income of an assessee is reduced by the earned income allowance only for purposes of determining the rate of income-tax.

For other purposes, e. g., for calculating the amount of exempted income in respect of insurance premia and provident fund contributions, the basis is the unreduced total income. The rate applicable for computing the amount of income-tax relief on account of exempted income will, however, be the rate applicable to the reduced total income.

Super-tax. No earned income relief is granted for the purpose of calculating the amount of super-tax. The super-tax is therefore computed on the amount of the total income. But the rates of super-tax applicable to the earned income and the unearned income are different, the rates applicable to the former being lower than those applicable to the latter.

Test Questions

1. What is earned income ? What relief is allowed to assessees in respect of the earned income ? *(Agra LL B. 1947)*

2. What do you understand by the term 'earned income' ? Who is entitled to the earned income relief in the income-tax assessment for 1947-48 and to what extent ? Explain the admissibility of the earned income relief to an individual, a Hindu undivided family, a company, a registered firm, and an unregistered firm. Illustrate your answer by suitable examples. *(Agra M. Com. 1946)*

3. A. B. C. is a registered firm carrying on business in British India and its partners are A, B and C. A joined the army two years back and C has merely financed the business. The profits of the firm amount to Rs. 42,000 and are shared in the proportion of 1/6, 2/6 and 3/6 respectively. What earned income relief is admissible and to whom ?

4. The standing counsel of the Income-Tax Department is paid a retaining salary of Rs. 200 per month. He received fees of Rs. 10,000 from the Department for conducting cases during the financial year 1946-47. What is the earned income relief to which he is entitled in 1947-48 assessment ?

CHAPTER 6

COMPUTATION OF TAXABLE INCOME (I)

Section 6 lays down the different sources of income liable to tax, viz— Salaries; Interest on Securities; Income from Property, Profits of Business Profession or Vocation; Income from Other sources; and Capital Gains. The method of computing the taxable income under each head is explained in detail in sections 7, 8, 9, 10, 12 and 12-B.

1. Salaries

Under section 7, tax is payable by an assessee in respect of any salary or wages due to him whether paid or not. Any portion of salary withheld under an order of a court is liable to tax. A salary wherever paid is taxable if it is earned in British India except pensions payable outside India (not British India). That is to say, a pension payable without India is exempt unless it can be taxed on the basis of ordinary residence.

The salary chargeable under this section is the salary paid by Government, a local authority, a company, any other public body or association, or any private employer. Therefore salary or pension paid by a foreign government or an Indian State is not chargeable under this section, but would be taxed under section 12 as income from other sources.

The following benefits received by an employee from his employer are included under the head salaries :—

1. Any bonus, annuity, pension, gratuity, fees, commission, perquisite or other allowance or profit in lieu of or in addition to salary. Such perquisites as, for example, tiffin, domestic services or the value of passage by rail or steamer provided by employers free of charge to their employees are not taxable, because they are not convertible into money. But passage money paid in India by an employer to his employee to enable the latter to go on leave is liable to tax.

2. House rent allowance or the value of a rent-free house provided by the employer not exceeding 10 per cent. of the salary of the employee.

3. Advances on account of salary are deemed to be salary due on the date when the advance is received. It must be distinguished from other advances such as house building advances, which are in the nature of loans.

4. Income-tax or super-tax paid by the employer on behalf of the employee in respect of the employee's salary.

5. A payment received by an employee from an employer or former employer as remuneration for past services and *not* as compensation for loss of employment. Payments made solely as compensation for loss of employment are, therefore, exempt.

6. A payment received from an unrecognised provident or other fund, except to the extent to which it consists of the return of the employee's own contributions and interest thereon, will be considered profits in lieu of salary and assessed as such unless the payment is made solely as compensation for loss of employment and not by way of remuneration for past services.

Note. Under section 7 (2) all servants of government including those whose services have been lent at a local authority established in exercise of the

powers of the Crown Representative or the Central Government are liable to pay tax on their salaries if they are employed in any part of India, irrespective of their nationality. No income-tax is, however, chargeable in respect of.

(a) the pay of officers whose services have been lent to and whose salaries are paid by Indian States ; or

(b) the portion of salaries of government officers serving in Indian States which is paid in the first intstance by the Central Government or the Crown Representative but is subsequently recovered from the States concerned ; or

(c) leave allowances for leave earned during the period of service in an Indian State ;

unless such salaries are liable by virtue of other provisions of the Act, e.g.,

(i) on a receipt basis under section 4 (1) (a) ; or

(ii) by being brought into or received in British India under section 4 (1) (b) (iii) by a person resident ; or

(iii) owing to the recipient being ordinarily resident the income is to be included in his total income subject to the exemption of Rs. 4,500.

Deductions. The expenditure incurred by an employee out of his salary for purposes of his employer's work is to be deducted from salary in order to compute the taxable income under this head, But two conditions have to be fulfilled before this exemption can apply. The expenses incurred by the employee must be wholly and necessarily incurred in the performance of his duties as an employee ; and the allowance must have been granted by the employer with the said purpose of meeting the extra expenses only.

Exempted lump sum receipts. The following classes of lump sums are not taxable in the hands of the recipient nor are they to be included in his total income. They are to be ignored altogether for assessment purposes.

1. A sum received as the accumulated balance at the credit of a subscriber to a recognised provident fund or a provident fund governed by the Indian Provident Funds Act of 1925.

2. A sum received from an approved superannuation fund on the death of a beneficiary or in lieu of or in commutation of an annuity or by way of refund of contributions on the death of a beneficiary or on his leaving the employment.

3. A sum received as compensation for loss of employment.

4. A sum received as commutation of a pension or by way of compensation for death or injury.

5. A sum received in payment of an insurance policy, unless it is of a revenue nature.

6. A legacy, a prize won in a lottery, or any other lump sum which is of a casual nature.

Earned income relief. Income chargeable under the head salaries is treated as earned income in the case of all assessees. The annual accretion in any year to the balance at the credit of an employee participating in a recognised provident fund, which is included in his total income and which is exempt from income-tax, will be treated as salary for the purpose of computing the earned income allowance.

Deduction of tax at source. This will be explained in detail in a subsequent chapter.

Illustrations

1. Find out the taxable income from salary for the previous year 1946-47 in the following cases :—

(a) On 1st June 1946 a person was engaged as a salesman in a trading firm on a salary of Rs. 250 per month and a commission of 5% on all orders secured through him. Three months after his appointment he was, however, discharged on payment of Rs. 1,000 as compensation for the termination of employment. The value of orders secured through him during the period of his service amounted to Rs. 12,500.

(b) B is the managing director of a large chemical works on a monthly salary of Rs. 1,500, a commission of 2½% on the net profits and a motor-car allowance of Rs. 100 p.m. He is also provided with a house whose annual rental value is Rs. 900. The net profits of the business for the year were Rs. 45,600. As an ex-employee of the Gwalior State he is also getting a pension of Rs. 300 per month.

(c) For many years D has been in the service of a firm on Rs. 200 p. m. but on 1st July 1946 he was retrenched. He was participating in an unrecognised provident fund maintained by his employer. His own contributions to such provident fund and interest thereon amounted to Rs. 3,450. On leaving the service he was paid by his employer, secured another appointment carrying a monthly salary of Rs. 180.

(a)	Salary for 3 months		750
	Commission		625
	Income taxable as salary	Rs.	1,375
(b)	Salary		18,000
	Commission		1,140
	Car allowance		1,200
	Value of rent-free house		900
	Income taxable as salary	Rs.	21,240

Note. The pension paid by the Gwalior State is not taxable under the head salaries. It is taxable as income from other sources under section 12.

(c)	Salary for 4 months at 200 per month		800
	„ „ 5 „ 180 „		900
	Amount received from an unrecognised provident fund	5,750	
	Less own contribution and interest thereon ...	3,450	2,300
	Income taxable as salary	Rs.	4,000

Provident Funds

The provident funds, of which a salaried person may be a member, are of three classes :—

1. Provident Funds to which the Indian Provident Funds Act of 1925 applies, e. g. provident funds maintained by railway companies, local authorities, universities, etc,

When a person is a member of such a provident fund, only his own contributions thereto are included in his salary for income-tax purposes, and no note is taken of his employer's contributions and interest on the accumulated balance to his credit.

An employee's own contribution to such a provident fund together with any life insurance premium is exempt from income-tax (but not from super-tax) up to one-sixth of his total income Rs. 6,000 whichever is less.

A sum received as the accumulated balance at the credit of a subscriber to such a provident fund is not taxable in the hands of the recipient nor is to be included in his total income.

2. Recognised Provident Funds. A recognised provident fund is one which conforms to the conditions laid down in section 58-C of the Act and which has been recognised by the Commissioner of Income-tax. The income-tax provisions regarding a recognised provident fund are :—

Contributions made to a recognised provident fund by the employer and the interest credited to the employee's provident fund are also included in the statutory total income of the employee.

The Contributions to a recognised provident fund both by the employee and the employer taken together are exempt from income-tax (but not from super-tax) up to one-sixth of the employee's annual salary or Rs. 6,000 which ever is less, *the salary for this purpose meaning the regular payment received by the employee (from which provident fund is deducted) and not any extras that are included in the term salary under section 7*, such as the value of a free house or a bonus, etc.

An employee is also entitled to obtain rebate of income-tax on life insurance premiums subject to the limit that the contributions (both his own and his employer's) to the recognised provident fund and the insurance premium taken together should not exceed one-sixth of his total income or Rs. 6,000 whichever is less. *The total income for this purpose is taken to be exclusive of the employer's contribution and the interest on the provident fund.*

Interest credited on the accumulated balance of an employee is also exempt from income-tax (but not from super-tax) if it does not exceed one-third of his annual salary and the prescribed rate, namely, 6 per cent p. a.

The accumulated balance due to an employee on his retirement is also exempt from both income-tax and super-tax and is not to be included in his total income.

3. Unrecognised Provident Funds. The contributions made by an employee to an unrecognised provident fund are *not* exempt from income-tax but the periodical contributions made by an employer towards the employee's provident fund are not taxable year after year in the hands of the employee.

A payment of the accumulated balance from an unrecognised provident fund made to an employee (less his own contributions and interest thereon) is however taxable and is to be included in his salary in the year of receipt. Any life insurance premium paid by a member of an unrecognised provident fund is, however, entitled to rebate subject to the usual conditions.

Illustration

A person is in receipt of a salary of Rs. 600 per month, 10% of which he contributes to a provident fund to which his employer also contributes a similar amount. He is provided with a rent-free house by his employer, the rental value of the house being Rs. 600 per annum, and he also received a sum of Rs. 1,200 as bonus from his employer.

The amount of interest credited on his provident fund at 4 per cent per annum is Rs. 450, and he paid Rs. 1,000 as life insurance premium.

Ascertain his income-tax liability if the provident fund in question is *(a)* a provident fund to which the Indian Provident Funds Act of 1925 applies, *(b)* a recognised provident fund, or *(c)* an unrecognised provident fund.

The income-tax liability in each of the three cases will be as follows :—

(a)	Salary (Total Income)		Rs. 9,000
	Exempted Income		
	1. P. F. Contribution	720	
	2. Life premium	780	
		1,500	
(b)	Salary		Rs. 9,000
	Employer's contribution		720
	Interest on P. F.		450
		Total Income	10,170
	Exempted Income		
	1. P. F. Contributions	1,200	
	2. Life premium	300	
	3. Interest on P. F.	450	
		1,950	
(c)	Salary (Total Income)		Rs. 9,000
	Exempted Income		
	1. Life premium	1,000	

Approved Superannuation Funds

An approved superannuation fund is one which satisfies the conditions laid dawn in section 58-P, and which has been approved by the Central Board of Revenue. The income-tax concessions enjoyed by a member of an approved superannuation fund are :—

The contribution made by an employee to an approved superannuation fund is treated in the same way as a payment of life insurance premiums under section 15. Therefore such contribution along with any life insurance premium is exempt from income-tax (but not from super-tax) to the extent of one-sixth of his total income or Rs. 6,000 whichever is less.

Any payment from an approved superannuation fund made on the death of a beneficiary or in lieu of or in commutation of an annuity or by way of refund of contributions on the death of a beneficiary or on his leaving the employment is also exempt from tax altogether in the hands of the recipient.

Illustration

1. In the cases mentioned below calculate for the previous year 1946–47 the taxable income from salary and also the amount of exempted income entitled to income-tax relief :—

(a) X is a government servant drawing Rs. 1,350 p. m. on 1st April 1946, his annual increment of Rs. 50 per month being due from 1st January 1947. A 5% deduction is made from his salary for securing a deferred annuity to him. He is also provided with a rent-free house of the rental value of Rs. 100 p. m. He pays Rs. 3,000 per annum as premia on his life policies.

(b) Y is an employee of a jute mill company with a monthly salary of Rs. 600. He contributes 10% of his salary to a recognised provident fund, his employer also contributing a similar sum. The interest (at 4% p. a.) on his provident fund account for the year amounted to Rs. 536. On 1st January 1947 he was paid by his employer one month's salary as bonus in respect of which no contribution is made to the provident fund. His life insurance premium amounted to Rs. 2,560 for the year.

(a)	Salary for the year	...	...	...		16,300
	Value of rent-free house	...	...	...		1,200
	Income taxable as salary	...	...	...	Rs.	17,500

Exempted income :

1.	Amount deducted to secure a deferred annuity		...		815
2.	Life insurance premium	...	...		2,101
				Rs.	2,916

(b) Salary for the year with Bonus which is the taxable income under the head salaries .. .. Rs. 7,800

Exempted Income :

1.	P. F. contributions (not exceeding $\frac{1}{6}$ of annual salary				1,200
2.	Life insurance premium	...	...		100
3.	Interest on P. F.	...	...		536
				Rs.	1,836

2. On 1st July 1945 a person was engaged as an assistant in a mercantile office on Rs. 200 in the grade of Rs. 200-10-300. In March 1946 he received Rs. 400 as an advance of pay to be recovered in eight equal monthly instalments. What would be his taxable income from salary for 1945–46 and 1946–47 ?

1.	Salary for 8 months	...	...	...		1,600
	Advance of salary	...	...	...		400
	Taxable as salary for 1945–46		...	...	Rs.	2,000
2.	Salary for the year	...	...	...		2,480
	Less advance recovered	...	...	...		400
	Taxable as salary for 1946–47		...	...	Rs.	2,080

3. Under section 14 (2) (c) of the Income-tax Act, income accruing or arising in an Indian State is exempt. Having regard to this provision state giving full reasons whether the income from salary in the following cases is exempt or not :—

(a) Leave salary drawn in Kashmir State by an officer of the Burma Government in respect of leave earned in Burma ;

(b) Leave salary drawn in an Indian State by a servant of the Central Government ;

(c) Salary paid in an Indian State to a servant of His Majesty by or on behalf of the Crown ;

(d) Salary paid in the first instance by the Central Government but subsequently recovered from the State to an officer on deputation in the State. The officer is ordinarily resident in British India ;

(e) An engineer of an Indian State on deputation in British India receives here a compensatory allowance of Rs. 1,000 per month which is claimed to be exempt. As regards the salary of Rs. 2,000 per month it is payable by the government to the State which in turn pays it to the engineer in the State.

(a) Since the separation of Burma in 1937, it does not form part of British India, and thus both Burma and Kashmir are outside the purview of the Indian Income-Tax Act, and no question of assessment arises in this case.

(b) The leave salary drawn in an Indian State by a servant of the Central Government is not exempt, because under section 7 (2) the salary paid from Indian revenue to a government servant (whether British subject or not) in any part of India including Indian States) is deemed to be salary paid in British India, and as such is chargeable.

(c) Salary paid in an Indian State to a servant of His Majesty by or on behalf of the Crown is not exempt, because the salary or the leave salary of an employee, wherever he may have been residing and wherever it may have been paid, is deemed to have accrued or arised in British India, provided it is earned in British India.

(d) In this case, though the income is exempt from tax, yet it shall be included in the total income of the assessee subject to a reduction of Rs. 4,500 for rate purposes. If this income is actually remitted to British India, it will be taxed.

(e) The engineer will have to pay tax on his monthly salary of Rs. 2,000 because the salary or the leave salary of an employee, wherever he may have been residing and wherever it may have been paid, is deemed to have accrued or arisen in British India, provided it is earned in British India.

The compensatory allowance or Rs. 1,000 per month is taxable, because an assessee has to pay tax on all income received or deemed to be received in British India in the previous year, irrespective of whether it accrued or arose within or without British India, unless it is an allowance paid by the Indian State in British India during the period of deputation for training in British India.

Life Insurance Premiums

The premium paid for insurance on the life of the assessee or on the life of his wife or her husband (or in the case of a Hindu undivided family, on the life of any male member or his wife) is exempt from income-tax provided (i) the annual premium does not exceed 10 per cent. of the sum assured exclusive of any bonus addition ; and (ii) the annual premium together with any exempted provident fund contributions does not exceed, in the case of an individual, one-sixth of his total income or Rs 6,000 whichever is less and, in the case of a Hindu undivided family, one-sixth of its total income or Rs. 12,000 whichever is less.

Out of the premiums paid in respect of a policy that covers the risks of sickness and accidental injury and also the risk of death, only so much as is attributable to the risk of death (from whatever cause) is exempt from income-tax

No rebate of income-tax is allowed on any sum withdrawn by an assessee from his provident fund in order to pay his life insurance premiums.

Although insurances on the life of a child do not entitle the assessee to the concession, yet it should be noted that certain kinds of insurance, which

are for the benefit of the child, should be treated as insurance on the life of the assessee. Policies are often taken by assessees with a view to securing the provision of a lump sum for their childern (i. e., for their education, marriage or other purposes) at a stipulated time, and the sum assured becomes payable on that date even if the assured dies after paying only one premium. An assurance of this kind is really an insurance on the life of the assessee, as it is designed to secure in the event of the assessee's early death (though not immediately after his death) a benefit considerably greater in amount than the annual payments which he has made, and consequently the premiums on such policies are eligible for rebate. The criterion that should be adopted in such cases is whether or not there is a contract dependent on the life of the assessee.

No relief is admissible on premiums paid out of income accruing or arising outside British India where such foreign income is not chargeable to Indian income-tax.

II Interest on Securities

Under section-8 tax is payable on the interest from government securities and debentures of companies and local authorities. However, the dividend on the shares of the Reserve Bank of India is included in interest on securities. In computing the taxable income from such interest the following allowances are admissible :—

1. Bank commission for collecting interest.

2. Interest on loans taken specifically for purchasing securities provided that any interest chargeable to tax but payable without British India is not allowed unless either it is interest on a public loan issued before 1st April 1938 or income-tax has been paid thereon or deducted therefrom or there is an agent in British India who may be treated as an assessee on behalf of the non-resident.

Notes :—(1) If a loan is taken to purchase tax-free securities, then the interest on such loan should be deducted from the tax-free interest.

(2) There can be loss under this head if the interest paid on a loan taken to buy securities exceeds the interest on securities. Such a loss is entitled to be set off against income under other heads.

(3) Interest on securities is taxed *when received ;* but where it is part of the profits of a business, profession or vocation adopting the mercantile system of accountancy, it would be taxed on an accrual basis.

Tax-free Government Securities. Interest from tax-free government securities is not liable to tax, although it is included in the total income of the assessee for the purpose of determining the rate of tax applicable to him. The 5 per cent. 1945-55 loan of the Central Government is the only tax-free security now in existence.

Cum-dividend and ex-dividend transactions.—With regard to the cum-dividend and ex-dividend transactions in securities, it is to be noted that for income-tax purpose the dividends and interest are the income of the owner of securities on the dates on which the dividend or interest falls due for payment, *except* in case of a bond-washing (see Chapter IX). Thus if a security is sold cum div. (the purchaser drawing the interest and not the vendor), the vendor cannot claim for the purpose of assessment that the interest should be treated as his income. If, however, he is a dealer in securities, the profit from the purchase and sale of securities will be taxable in his hands, because it would then be income and not capital.

Tax-free commercial securities. Here "Tax-free" means that such securities (i. e., shares and debentures issued by limited companies free of tax) are not actually free from tax, but that the security-holders have not to pay tax again from their own funds, because the company has already paid tax from its undivided profits on behalf of the security-holders. The amount of income which is received by the security-holders in the shape of tax-free dividend or tax-free interest is therefore the net amount of income and has to be grossed up for assessment purposes.

Note.—The phrase "Less tax" in the case of both government and commercial securities means one and the same thing, viz., that the security-holders have to bear the tax as only the net amount of income is handed over to them.

Illustrations

1. A's investments for 1946–47 were :—(a) Rs. 40,000 3½% Government Paper ; (b) Rs. 20,000 5% Municipal Debentures ; and (c) Rs. 60,000 4½% Port Trust Bonds. His Bank charged him Rs. 10 commission for collecting interest on the investments and he paid Rs. 700 as interest on a loan which he had specifically taken for purchasing the Municipal Debentures. What is his taxable income from interest on securities ?

Interest for the year on all securities		5,100
Less Bank Commission	10	
Interest on the loan	700	710
Taxable income from interest on securities		Rs. 4,390

1. On 1st April 1946, X held the following investments :—(a) Rs. 80,000 3% Government Loan ; (b) Rs. 60,000 3½% Bombay Port Trust Bonds ; (c) Rs. 80,000 5% Improvement Trust Debentures ; and (d) Rs. 30,000 5% Government Loan.

On 31st August 1946 he purchased Rs. 20,000 4% Government Bonds (interest payable 1st June and 1st December) at 92½ c. d.

His Bank charged him Rs. 25 as commission for collecting interest. Calculate his taxable income from interest on securities.

Interest on securities existing on 1st April 1946		10,000
Interest on 4% Bonds for half-year		400
		10,400
Less Bank Commission		25
Taxable income	Rs.	10,375

3. On 1st April 1946, B's investments consisted of the following :—

(a) Rs. 60,000 4% U. P. Government Loan ;

(b) Rs. 30,000 5% Calcutta Improvement Trust Debentures ;

(c) Rs. 20,000 5% Government Paper ;

(d) Rs. 15,000 6% Preference of a cotton mill company.

On 1st September 1946, he sold the Rs. 20,000 5% Government Paper and purchased Rs. 40,000 6% Calcutta Port Trust Bonds. The additional sum of Rs. 20,000 needed for the purpose was borrowed from the Bank at 6 per cent. per annum interest. The Bank charged commission for selling and buying of the securities at the rate of one anna per cent, and for collecting

interest and dividend at the rate of four annas per cent. calculated on the gross amount of interest or dividend, which in each case is payable half-yearly on 1st January and 1st July.

Find out his taxable income from interest on securities

Interest on 4% U. P. Loan for one year		...	2,400
Interest on 5% Calcutta Improvement Trust Debentures for one year		...	1,500
Interest on 5% Government paper for half year		...	500
Interest on 6% Calcutta Port Trust Bonds for half year		...	1,200
			5,600
Less Bank Commission ¼%	14		
Interest on the loan for 7 months	700		714
	Taxable Income		Rs. 4,886

Note.—The dividend on shares is not to be taxed under the head "Interest on Securities", but it will be taxed under the heading. "Income from Other Sources".

The Bank's buying and selling commission cannot be deducted as it is in the nature of capital expenditure.

III. Income from Property

Under section 9, tax is payable by an assessee on the **bona fide** annual value of property consisting of buildings or land appurtenant thereto, of which he is owner, other than such portion as may be used for his business, profession or vocation, the profits of which are assessable to tax.

It is only the owner who is liable to pay tax under this head. Where a person derives some income from house property which he holds on lease, such income is chargeable under section 12. Similarly income from lands not attached to a building is chargeable not under this section but under section 12.

Annual Value. Tax under this head is chargeable in respect not of any actual rental received but of the **bona fide** annual value. The **bona fide** annual value of a building is the annual rent at which it can be let from year to year, if the owner bears all owner's burdens including municipal taxes or taxes chargeable from the owner and if the tenant bears all tenant's burdens including municipal rates and taxes chargeable from the tenant.

But if the property is in the occupation of the owner, the annual value thereof shall not exceed ten per cent. of his total income.

No deductions from the annual value are permissible on account of any municipal or local rates or taxes in respect of property. Where, however, under the tenancy agreement the owner pays the occupier's share of municipal tax, then the amount included in the rent on account of such tax is deductible from the gross rent for the purpose of arriving at the **bona fide** annual value. On the other hand, if there is a stipulation that the tenant will, in addition to the regular rent payable to the *owner, pay to the municipality* the owner's share of tax, then such tax must be deemed to be a part of the rental value and must be added to the rent in order to arrive at the **bona fide** annual value.

Where the property is situated in a municipal town, the municipal valuation of the property or the actual rent receivable (if let), whichever is greater, is ordinarily taken to be the annual value of the property.

Deductions. In computing the taxable income from property, the following deductions are allowed from the annual value :—

1. One-sixth of the annual value for repairs, irrespective of whether anything has been spent on repairs or not. This allowance will also be granted in full even when an allowance is given for vacancies. Where the property is let and the tenant has undertaken to bear the cost of repairs, the amount allowable is the difference between the annual value and the rent paid by the tenant up to, but not exceeding, one-sixth of the annual value.

2. Premium paid for insurance against risk of destruction of property, e. g., fire, earthquake, lightning, civil commotion, etc.

3. Interest on mortgage or charge on the property irrespective of the object for which the money is borrowed.

4. Annual charge on property which is not of a capital nature.

5. Interest on capital borrowed for the purchase, construction, repair or renewal of property.

Note. The above three allowances (Nos. 3-5) will not be granted, if they are payable to a non-resident, unless tax has been deducted therefrom at the maximum rate or the owner of the property agrees to be taxed as an agent of such non-resident.

6. Any ground rent to which the property is subject.

7. Any land revenue paid in respect of the property.

8. Collection charges, being 6 per cent. of the annual value or the actual amount whichever is less. Legal expenses incurred in recovering rents from tenants are included in collection charges; but *only* the net expenses (i. e., after deducting any costs recovered from the opposite party) are deductible.

9. Vacancy allowance, being that part of the annual value which is *proportionate to the period during which the property remains vacant.* Where an assessee owns a house and keeps it ready for his own occupation or for the occupation of his guests, the house cannot be said to be vacant merely because it was not occupied for a certain period.

10. Under section 60, a deduction in respect of unrealised rent is allowed from the taxable income from property thus ascertained, if the following conditions are satisfied:—The tenancy is **bona fide**; the defaulting tenant has vacated or steps have been taken to campel him to vacate the property; the defaulting tenant is not in occupation of any other property of the assessee; and the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent.

Note. The allowances (2-8 above) must be supported by proof of actual expenditure but not necessarily of actual payment.

Should the admissible allowances exceed the annual value of property, there will be loss from property; and this will be set off against income from other sources.

As the tax on income from property is levied on a notional basis, there is no provision in section 9 (as there is in sections 10 and 12) regarding the method of accounting to be adopted.

Property owned jointly. Where a property is owned jointly, and the shares of the co-owners are definite and ascertainable, they are not assessed as an association of persons, but the share of each part-owner is assessed on him as part of his total income.

Illustration

Four persons combined to purchase a house property in equal shares. Its net annual income amounts to Rs. 6,000, which is assessed jointly as income of an association of persons. It is claimed that the assessment should be made separately and the income of each being below Rs. 2,500, on tax is payable by them.

How will you deal with this case ? Give reasons for your answer.

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Although the property is purchased jointly, yet the respective shares of the joint owners are definite and ascertainable. Therefore each joint owner should be assessed separately in respect of his share of the property income. If each joint owner has no other income he is not liable to pay any tax.

Exempted Property Income. This is a new head of exemption introduced for the first time by the Income-Tax Amendment Act of 1946. In order to encourage private construction of residential buildings, exemption has been granted from tax in respect of the **bona fide** annual value of all such buildings as are commenced and completed between 1st April 1946 and 31st March 1950. This exemption will be available only for a period of two years from the date of the completion of buildings ; and it does not apply to buildings used for business purposes.

Illustrations

1. B is employed as a clerk in a government office on a monthly salary of Rs. 120 and his investments consist of Rs. 20,000 7% Debentures in a public utility concern. He is also the owner of a large house whose municipal valuation is Rs. 800, about a third of which he has let at Rs. 30 a month, using the remainder for his residence. The whole house is mortgaged for a loan which he took for the marriage of his sister, and the interest on the loan amounted to Rs. 300 for the year.

Find out his taxable income from property and also his total income.

Gross annual value of portion let		Rs. 360	
Less 1/6 for repairs	60		
Proportionate interest on mortgage	100	160	200
Gross annual value of portion occupied (limited to 10% of the total income)		309*	
Less 1/6 for repairs	51		
Proportionate interest on mortgage	200	251	58
Taxable income from property		...	Rs. 258

Statement of total Income :—

1.	Salary	Rs. 1,440
2.	Interest on securities	1,400
3.	Income from Property	258
	Total Income	Rs. 3,098

*This is ascertained as follows :—Let the gross annual value of the property occupied by the owner be x ; then the total income would be.

$1,440+1,400+200+(x-\frac{1}{6}x-200)$

i.e. $x-\frac{1}{6}x+2,840$.

Hence $x = 10\%$ of $x-\frac{1}{6}x+2,840$.

i.e. $x = 309$.

In order to calculate the gross annual value of the property occupied by the owner (restricted to 10 per cent. of his total income) the following formula can be readily applied :—

Gross annual value of the residential property is equal to $\frac{1}{10}$ of $\frac{12}{11}$ of other taxable income *minus* expenses (other than the 1/6th statutory allowance for repairs) in respect of residence.

Thus using the figures given in the above question, the gross annual value of the property occupied by the owner would be.

$$\frac{1}{10} \text{ of } \frac{12}{11} \text{ of } \{ (1440+1400+200) - 200 \} \text{ or Rs. } 309.$$

2. The property of a person consists of three houses, of which the municipal valuation is Rs. 600, Rs. 500, and Rs. 760 respectively. The first house is used entirely for purposes of his business (the profits of which are chargeable to tax), the second is half occupied for his residence and half let at Rs. 25 per month, while the third house is wholly let at Rs. 60 a month.

His expenses in connection with the second and third houses are : Repairs Rs. 165 ; Ground rent Rs. 56. The second house is also subject to an annual charge (not being a capital charge) of Rs. 125.

Calculate his taxable income from property, assuming that the taxable profits of his business amount to Rs. 3,200.

The income of the house, which is used for purposes of the business, the profits of which are chargeable to tax, is not taxed under the head income from property, in the case of the house which is partly used as a residence and partly let, the annual value is determined on the basis of the rent received for half the portion ; and in respect of the third house the municipal valuation is taken to be the annual value, because the actual rent receivable is less.

Gross annual value : 2nd house		Rs. 600	
3rd house		760	1,360
Less : 1/6 for repairs	... ...	226	
Ground rent	... ...	56	
Annual charge	... ...	125	407
Taxable income from property			Rs. 953

Note :—The annual value of that portion of property which is occupied by the owner is less than 10 per cent. of the total income which is Rs. 4,153.

3. X is employed as a professor in a college on Rs. 800 p. m. He contributes $6\frac{1}{4}$% of his salary to a recognised provident fund maintained by the college, the college also contributing the same amount to his provident fund account. The interest (at $3\frac{1}{4}$% p. a.) on his provident fund account for the year amounted to Rs. 672.

He also owns two houses—one (municipal valuation Rs. 800) occupied by him for his residence and the other (municipal valuation Rs. 1,000) let at Rs. 100 a month. His expenses in respect of property are :—

(a) Interest on mortgage on both houses	... ...	Rs. 1,200
(b) Land revenue for both houses	... ...	40
(c) Premium for insurance against destruction of both houses		120
(d) Interest on loan taken to repair his residential house	...	125
(e) Cost of extensions of electrical fittings	... ...	105

The house which is let remained vacant for two months during the year.

Ascertain *(a)* taxable income from property, *(b)* total income, and *(c)* the amount of exempted income, assuming that he paid Rs. 850 as premia on his life policies for Rs. 25,000. *(Agra B. Com. 1946)*

(a) Annual value of property let	...		1,200	
Less $\frac{1}{6}$ for repairs	...	200		
Interest on mortgage	...	720		
Land revenue	...	24		
Insurance premium	...	72		
Vacancy allowance	...	200	1,216	-16
Annual value of property occupied	...		800	
Less $\frac{1}{6}$ for repairs	...	133		
Interest on mortgage	...	480		
Land revenue	...	16		
Insurance premium	...	48		
Interest on loan	...	125	802	-2
Income from property			Rs.	-18

Note :—The expenses common to both the houses have been apportioned according to annual value. The cost of extensions to electric fittings is capital expenditure.

(b) Salary	...	9,600
Employer's contribution to P. F.	...	600
Interest on P. F. a/c	...	672
Loss from property	...	-18
Total Income	Rs.	10,854

(c) **Exempted Income :**

1. P. F. contributions	...	1,200
2. Life insurance premia	...	397
3. P. F. interest	...	672
		Rs. 2,269

4. A person owns two houses whose annual letting value is Rs. 6,000 and Rs. 2,000 respectively. The first house was purchased some ten years ago but the second house was constructed in the period from 15th June 1946 to 1st December 1946.

Rs. 200 a year is payable for the ground rent of the land on which the old house stands; but as it was in arrear for the last three years he had to pay Rs. 800 during the year ended 31st March 1947.

The new house has been constructed with borrowed capital on which he paid 6 per cent. per annum interest.

What would be the taxable income from property for the assessment year 1947-48 ?

The income of the second house, which has been constructed in the period from 1st April 1946 to 31st March 1948, is totally exempt from tax. The taxable income of the first house will be as follows :—

			Rs.
Annual letting value	...		6,000
Less one-sixth for repairs	...	1,000	
Ground rent for one year	...	200	1,200
Taxable income from property			Rs. 4,800

The interest on the borrowed capital has been paid in connection with the new house, the income of which is exempt; therefore the amount of the interest will also be ignored.

Test Questions

1. How do you compute the taxable income of an assessee under the head salaries? Does a salary or pension received by a person resident in British India from an Indian State come under this head?

2. How is the amount of tax to be deducted monthly from the salary of an employee calculated? Show by means of an example.

3. What relief from income-tax is allowed in respect of life insurance premiums and provident fund contributions and interest on provident fund?

4. Under the head interest on securities, an assessee shows an income of Rs. 200, but the certificate under section 18 (9) shows Rs. 300. The difference is explained to be due to the extra price paid by the assessee to Government as the purchase price increased weekly by approximately the net interest accrued. What is the taxable income from interest on securities?

5. During the year ended 31st March 1946, A, a non-resident British subject, received the following amounts :—

Description of income	Where received	Amount Rs.
1. Compensation for pre-mature termination of employment	British India	50,000
2. Leave salary earned by service with Government of India in Delhi	Indian State The U. K.	6,000 3,000
3. Salary paid on behalf of the Crown for services rendered within the territory of an Indian state	Indian State	6,000
4. Pension payable under his contract of service in the U. K.	The U. K.	9,000

Is he liable to tax in British India? If so, what will be his total world income? Give reasons for including an item in or excluding it from his total income or total world income as the case may be.

(Income-tax Departmental Exam. 1946)

6. Describe the provisions of the Indian Income-Tax Act as applied to different kinds of Provident Funds. *(Agra B. Com. 1946)*

7. Under section 9 of the Indian Income-Tax Act, tax is payable by an assessee under the head 'Income from Property' in respect of the *bona fide* annual value of property.

Define 'Property' and 'Annual Value,' and state the deductions that are allowed from the annual value in computing the taxable income from property.

(Agra B. Com. 1946)

CHAPTER 7.

COMPUTATION OF TAXABLE INCOME (2)

IV. Profits of Business, Profession or Vocation

A business includes any trade, commerce or manufacture or any adventure in the nature of trade, commerce or manufacture. The definition makes it plain that the profits of even an isolated transaction, if it constitutes an adventure in the nature of trade, are taxable.

A profession is an occupation requiring purely intellectual skill or manual skill controlled by the intellectual skill of the operator, e. g., lawyer, accountant, doctor, surgeon, etc.

A vocation (as distinct from employment) is any other calling pursued for the purpose of earning one's livelihood, e. g., broker, insurance agent, singer, dancer, etc.

Under section 10 tax is payable in respect of the profits or gains of any business, profession or vocation carried on by an assessee. The fact that a business is illegal or unlawful does not affect liability to tax, that is, its profits are taxable.

There is, however, no definition of profits or gains. All that is stated in this section is that certain deductions alone are permitted in computing profits. The section assumes that the gross profit has been arrived at somehow ; and in regard to this matter it would appear that in the absence of any statutory provisions, the accepted principles of accounting should be followed and that the accounts should represent facts with truth and accuracy.

While it is not possible, owing to the variety of accounting systems, to prescribe exhaustive lists of deductions that are or are not permissible in the case of all businesses, the following deductions are permissible in the case of all businesses according to section 10 (2) :—

1. Rent of premises in which the business is carried on. But if any substantial part of the premises is used as a dwelling-house by the assessee, the amount of rent to be allowed will be so much as the I. T. O. may determine having regard to the proportionate annual value of the part so used.

If the rent is paid by a firm to a partner for the use of his premises, it is deductible from the profits of the firm.

Where the premises are owned by the owner of the business, no allowance on account of rent is permitted, because the owner is not liable to pay tax on the income of the property.

2. Repair of premises where the assessee is the tenant only and has undertaken to bear the cost of repairs. Where a substantial part of the premises is used as a residence by the assessee, the same proportion of the cost of repairs would be permitted as is taken in calculating the rent permissible.

3. Interest on capital borrowed for business purposes except *(i)* interest liable to tax payable abroad save under certain conditions (as given later in this chapter), and *(ii)* interest paid by a firm to a partner (whether on capital or on loan). The provision for disallowance of interest dependent upon the earning of profit has been withdrawn.

4. Premia for insurance against the risk of damage or destruction of buildings, machinery, plant, furniture, stocks or store used for the purposes of the particular business, profession or vocation under assessment, and no allowance can be made for premia for other insurances. Any sums not actually expended on premiums, but merely set aside as a reserve for insurance, cannot be allowed as a deduction.

5. Current repairs to buildings, machinery, plant or furniture used for business purposes. The phrase 'current repairs means such repairs required to keep these assets in serviceable condition as are rendered necessary by ordinary wear and tear (as opposed to accidental or wilful damage or other unusual causes) and are of their nature recurrent at comparatively short intervals. It also includes minor replacements of parts provided that such replacements are not of such an extensive nature as to a change the identity of the asset in question. But expenditure on an asset, that would have increased its capital value if it had been incurred when the asset was new, would be regarded as capital expenditure.

6. Depreciation. See Chapter 10.

7. Obsolescence. See Chapter 10.

Note.—Where any building, machinery, plant or furniture is not used wholly for business purposes, only a proportionate amount of the above four allowances (No. 4-7) can be claimed.

8. Loss on the sale of dead or useless animals used for business purposes.

9. Land revenue, local rates or municipal taxes in respect of such part of business premises as is used for business purposes. No allowance can be claimed on account of any other rates or taxes whatsoever.

10. Bonus to employees. Only bonafide payments of bonus to employees for services rendered is allowed where *(a)* it would not have been payable to them as profit or dividend if it had not been paid as bonus or commission; and *(b)* it is of a reasonable amount having regard to the pay of the employee and the conditions of his service, the profits of the business and the general practice in other similar businesses Such charges will be normally allowed as deductions unless there are grounds for suspecting that the amount of bonus or commission has been fixed with a view to avoidance of tax by the employer.

11. Bad and doubtful debts. An allowance for bad and doubtful debts is made on the following conditions :—

(a) If the accounts of the assessee in respect of that part of his business in which bad debts have occurred are kept on the mercantile basis and not on the cash basis; but in the case of a bank or money-lending business irrecoverable loans given in the ordinary course of business are allowed even if the books are kept on the cash basis.

(b) Only such amount as the I. T. O. estimates to be irrecoverable is allowed.

(c) The amount allowed should not exceed the amount actually written off in the books of the assessee.

(d) If the amount ultimately recovered on a book debt or loan is greater than the difference between the whole debt or loan and the amount so allowed, the excess would be deemed to be a taxable profit of year in which it is recovered: and if less, the deficiency would be allowed in that year as a business expense.

12. Any revenue expenditure laid out or expended on scientific research related to the business will be allowed.

13. Any sum paid to a scientific research association having as its objects the undertaking of scientific research related to the class of business carried on, and any sum paid to a university college or other institution will be allowed provided these bodies have been approved for the purpose by the prescribed authority.

14. The entire capital expenditure on scientific research related to the business is allowed in five annual consecutive instalments commencing from the accounting year in which the expenditure was incurred. The allowance is granted even if the research expenditure was incurred within three years prior to the commencement of the business.

15. The amount of any Business Profits Tax payable will be allowed as a deduction in computing the taxable income from business.

16. Miscellaneous business expenditure. Under the residual clause (xii) of section 10 (2) allowance is given for "any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purposes of such business, profession or vocation." The essential conditions that should be fulfilled in order that an expenditure may be allowed under this clause are :—

(i) It must be an expenditure :

(ii) It must not be of a capital nature or a personal expense ; and

(iii) It must be laid out or expended wholly and exclusively for the purposes of the business, profession or vocation.

Whether a particular expenditure has been incurred solely to earn the profits or whether it is capital expenditure depends in each case on the nature of the business, commercial practice, the nature of the expenditure and other circumstances. It is not therefore possible to enumerate what would or would not be admissible deductions under clause (xii). The following examples illustrate the general principles :—

(1) Advertising charges would be allowed if they were incurred in selling the goods in the ordinary course ; but if a special advertising campaign were undertaken for expanding the business or extending the activities of the business in new directions, the expenditure would be disallowed because it would then be in the nature of capital.

(2) Legal expenses would be allowed, if not for capital purposes, irrespective of whether the assessee won or lost, on the action. Expenses for fighting the liability to income-tax would not be allowed as the expenditure is by no means necessary for earning the income that is the subject of charge.

(3) Audit and other accountancy expenses incurred annually including expenses of settling the income-tax liability of an assessee are ordinarily allowed. But expenses connected with subsequent income tax proceedings before the higher authorities in appeal are not admissible.

(4) Embezzlement by or through the carelessness of an employee in the course of business is allowed as deduction, but not money lost through the person responsible for the business or money lost by theft.

(5) Broker's charges are allowed if for selling goods or securing orders, but not for raising loans or securing capital.

(6) Royalties paid for patents and copyrights are a permissible deduction.

(7) Premium for insurance against loss of profit can be allowed because the sum recovered under such an insurance policy is taxable as a trading receipt.

(8) Premium paid to insure the life of an employee who personally influences the business and whose death will cause a diminution of profits can be claimed as a deduction.

(9) Premia paid for insurance against accidents of employees as well as to cover the risk of liability under the Workmen's Compensation Act are allowed.

(10) Employer's contribution to a recognised provident fund is an admissible deduction under section 58-K.

(11) Unuder section 58-R the employer's contribution to an approved superannuation fund is also allowed.

(12) Contributions to an unrecognised provident fund by an employer are allowable if the fund is constituted as an irrevocable trust and if no part of the employer's contributions can be recovered by him. If the fund remains in the hands or under the control of the emyloyer, no contributions by him would be allowed as a deduction, but actual payments (of the employer's contributions only) made to employees leaving the service would be allowed in the year in which such payments are made, provided that, as required by section 10 (4) (c), effective arrangements are made for the deduction of tax from such payments.

(13) Contributions to an unapproved superannuation fund made by an employer are also allowable, if the fund is constituted as an irrevocable trust and if no part of the employer's contributions can be recovered by him. If such a fund remains in the hands or under the control of the employer no contributions by him will be allowed as a deduction, but actual payments of pensions to ex-employees or to their widows or children would be allowed as deduction when the pensionary payment is a fixed and securing one. No claims on account of pensions will, however, be entertained when they are paid to persons who have or who at any time had a share of interest in the business, profession or vocation.

(14) Subscriptions given by a business are allowed if their payment is commercially expedient and of benefit to the payer.

(15) Compensation paid to an employee on termination of the employment is deductible when it is not expedient in the interests of the employer to keep him.

(16) Compensation for the cancellation of a contract (if it was one for goods and not for capital assets) is an admissible deduction.

(17) Indian traders generally charge their customers a small fee on each transaction called *dharmada*, the proceeds of which are supposed to be devoted to various charitable purposes. Such customary receipts and the corresponding expenditure by the assessee should be left out of account altogether in computing the taxable income, provided the I. T. O. is reasonably satisfied that the sums in question are really applied by the assessee ultimately to the object for which they were ostensibly collected.

(18) Sales tax is allowed in proportion to sales.
(19) Muhurat ceremony expenses up to a maximum of Rs. 400.
(20) Loss of stock-in-trade by sinking of a boat.
(21) Loss by theft of money entrusted to an employee to be deposited in the bank,
(22) Loss of cheap grain shops.
(23) All welfare expenditure of a revenue nature,

Valuation of Stock. For computing the taxable income from business, it is necessary that a definite and uniform method of stock valuation should be adopted.

Inadmissible Expenditure

In computing the taxable profit of a business, profession or vocation the following expenses are *expressly* disallowed :—

1. Under section 10 (2) *(iii)* any interest chargeable under the Act which is payable without British India *except (a)* interest on which tax has been paid or from which tax has been deducted or in respect of which there is an agent in British India who may be assessed and *(b)* interest on a loan issued for public subscription before 1st April 1938.

2. Under section 10 (4) *(a)* any payment chargeable under the head salaries if it is payable without British India unless tax has been paid thereon or deducted therefrom.

3. Under section 10 (4) (b) any interest, salary, commission or remuneration paid by a firm to any partner of the firm, whether the firm is registered or unregistered.

4. Under section 10 (4) *(c)* a payment to unrecognised provident fund established for the benefit of employees unless effective arrangements have been made to secure proper deduction of tax from any payments made from such fund which are chargeable under the head salaries.

5. Drawings of proprietor of partners.
6. Private or personal expenses of the proprietor.
7. Reserve for bad debts or any other reserve.
8. Interest credited to reserves.
9. Expenditure in the nature of charity or presents.
10. Income-tax or super-tax or any other tax on income.
11. Expenditure in the nature of capital.
12. Rental value of the property owned and occupied for business.
13. Cost of additions, alterations, extensions or improvements to any of the capital assets of the business.
14. Past losses charged to Profit & Loss Account.
15. Depreciation in excess of the amount allowable.
16. Any other expenditure not incurred wholly and exclusively for purposes of the business.

N. B.—If any income is not shown in the Profit and Loss Account (e. g., interest derived from reserve fund investments transferred direct to the reserve fund and not shown in the Profit & Loss Account), such income should be included in the total income of the assessee. On the other hand, any non-taxable income shown in the Profit & Loss Account should be excluded from the total income.

Trade Associations. Just as the profits derived from business carried on by a local authority or a charity are taxable under certain conditions, so under section 10 (6) trade associations and similar bodies are taxable in respect of the profits made from performing specific services for members for remuneration definitely related to those services.

Illustrations

1. From the following P. & L. Account of a merchant for the year 1496, find out his taxable income from business and also his total income :—

Office Salaries	4,800	Gross Profit	35,672
General Expenses	1,200	Discount	751
Bad Debts written off	2,100	Commission	1,205
Reserve for Bad Debts	3,000	Bad Debts recovered	150
Fire Insurance Premium	450	Interest on Govt. securities	2,500
Advertising	2,500	Profit on sale of investments	3,000
Income-tax	2,375	Sundry receipts	52
Loss on sale of motor-car	1,200		
Interest on Capital	1,000		
Interest on Bank Loan	1,550		
Charity	150		
Loss of Building by fire (uninsured)	1,500		
Depreciation : Building	1,000		
Furniture	200		
Net Profit	20,305		
	Rs. 43,330		Rs. 43,330

The motor-car was used half for business purposes and half for the proprietor's private purposes. The amount of depreciation allowable, on the basis of the written-down value, in respect of buildings and furniture is Rs. 952. Included in advertising is a sum of Rs. 1,700 expended on a special advertising campaign undertaken during the year in respect of a new product placed on the market.

Net Profit as per Profit & Loss Account		Rs. 20,305
Add Expenditure not allowed :—		
1. Reserve for Bad Debts ...	3,000	
2. Advertising being in the nature of capital expenditure ...	1,700	
3. Income-tax ...	2,375	
4. Loss on sale of motor-car (½) ...	600	
5. Interest on Capital ...	1,000	
6. Charity ...	150	
7. Loss of building by fire ...	1,500	
8. Excess Depreciation ...	248	10,573
		30,878
Less Interest on Government securities not being from Business		2,500
		28,378
Less Profit on sale of investments being capital profit		3,000
Taxable income from business Rs.		25,378

1. Interest on Securities (from which income-tax amounting to Rs. 1,136-6-0 has been deducted at source)	3,636
2. Profit from business	25,378
Total Income Rs.	29,014

Notes. As the motor-car is partly used for business purposes, only one-half of the obsolescence loss is allowed in computing the taxable income from business.

The profit on the sale of investments is capital profit. If it was made before 31st March 1946, it is not taxable. If it was made after 31st March 1946, it would be taxable if it exceeded Rs. 15,000.

Annas and pies in the amount of income are ignored.

2. Below is given the Profiit and Loss Account of the Bharat Textile Mills, Ltd., for the year ended 31st December 1946 :—

Cotton	57,08,975	Yarn Account	54,05,978
Stores	9,17,824	Cloth "	48,12,056
Mill Salaries & Wages	1,15,992	Waste "	60,754
General Charges	14,504	Transfer Fees	3,108
Donations	5,000	Rents of Bungalows and Chawls	28,951
Rates and Insurance	20,188	Dividends	16,200
Brokerage	3,862		
Office Expenses	1,20,347		
Director's Fees	4,500		
Research Expenditure	60,000		
Auditor's Fees	2,500		
Interest	1,05,925		
Repairs to Building and Machinery	62,278		
Law charges	2,865		
Workmen's Welfare Expenditure	27,592		
Contribution of Staff Provident Fund	37,500		
Managing Agent's Commission	1,00,845		
Net Profit (subject to depreciation)	12,16,350		
	Rs. 1,03,27,047		Rs. 1,03,27,047

From the above account ascertain the company's taxable income from business and also its total income for the year 1946 after taking the following information into account :—

1. Rs. 2,700 of Brokerage was paid for cotton and stores purchased, and the balance was in respect of loans raised for the company's business.

2. Rates Rs. 1,800, Insurance Rs. 1,250 and Repairs to Buildings Rs. 2,872 were in respect of bungalows and chawls let to employees.

3. Legal charges amounting to Rs. 950 were incurred in connection with the purchase of additional land and buildings.

4. Two-thirds of the research expenditure is capital expenditure.

5. The Staff Provident Fund is a recognised one.

6. The amount of depreciation allowable for assets used for the company's business is worked out at Rs. 2,75,850.

Profit as per Profit and Loss Account			12,16,350
Add. Expenses not allowed .—			
1. Donations		5,000	
2. Brokerage for loans being capital expenditure		1,162	
3. Rates and Insurance of Buildings not used for business		3,050	
4. Repairs of Buildings not used for business		2,872	
5. Legal charges being in the nature of capital expenditure		950	
6. Four-fifth of capital expenditure on research		32,000	45,034
			12,61,384
Less Depreciation allowance ...		...	2,75,850
			9,85,534
Less Income not taxable under business :			
1. Rents of Bungalows and Chawls		28,951	
2. Dividends		16,200	45,151
Taxable income from business		Rs.	9,40,383
1. Income from Property :			
Gross annual value ...		28,951	
Less 1/6 for repairs ...	4,825		
Insurance ...	1,250	6,075	22,876
2. Profits of Business ...		...	9,40,383
3. Dividends gross (the amount of income-tax paid thereon being Rs. 7,363-10-0 for which credit is to be given) ...		...	23,563
		Total income Rs.	9,86,822

3. The following is the Profit & Loss Account of the U. P. Sugar Co. Ltd., for the year ended 30th June 1946 :—

Stocks of sugar and molasses on 1-7-45	6,72,725	Sale proceeds of sugar and molasses	22,24,944
Raw Materials	6,43,320	Rents from lands	2,645
Government Cane Cess	58,470	Crops (other than cane)	5,190
Manufacturing Expenses	2,64,405	Sundry receipts	2,835
Sugar Excise Duty	2,01,073	Stocks of sugar and molasses on 30-6-46	3,84,764
Farm Expenditure	76,235		
Salaries and Wages	1,89,396		
Marketing	25,412		
Insurance	20,218		
Establishment	35,914		
Directors' Fees	1,800		
Audit Fees	1,000		
Interest	20,424		
Debentures interest	20,000		
Managing Agents' Remuneration	48,067		
Taxation Reserve for fiscal year 1947-48	65,500		

Depreciation	35,000		
Net Profit	2,41,419		
	Rs. 26,20,378		Rs. 26,20,378

The company owns a large agricultural farm and the entire cane crop raised during the year (valued at Rs. 1,02,500 at average market prices of cane) was used in its own factory.

Sundry receipts include Rs. 540 being sale proceeds of Farm animals and implements.

Apparatus valued Rs. 35,000 purchased for the newly-started Company's laboratory and Rs. 375 being the cost of a pucca well built for the use of the Company's workmen stand debited to Manufacturing Expenses.

The amount of depreciation allowable in respect of Buildings, Machinery, Plant and Furniture is Rs. 28,450.

Ascertain the Company's taxable income from business.

Profit as per Profit & Loss Account		2,41,419
Add Expenditure disallowed :		
Farm expenditure	76,235	
Taxation reserve	65,500	
Depreciation	35,000	
Capital expenditure :		
Laboratory apparatus 4/5ths	28,000	
Cost of well	375	2,05,110
		4,46,529
Less the average market price of cane grown on the Company's own farm and used as raw material		1,02,500
		3,44,029
Less Depreciation allowance ...		28,450
		3,15,579
Less Agricultural income :		
Rents from lands	2,645	
Proceeds of other crops	5,190	
Proceeds of farm animals, etc.	540	8,375
Taxable income from business		Rs. 3,07,204

4. The P. & L. Account of the Assam Tea Co., Ltd., for the year ended 31st December 1946 is as follows :—

Stock of Tea on 1-1-46	2,37,490	Proceeds of Tea sold	7,65,980
Cultivation and Manufacturing Expenses	4,08,110	Profit on sale of building	15,000
Inland Freight	30,132	Stock of Tea on 31-12-46	2,05,318
Commission, Brokerage & lling Charges	35,521		
eral Charges	14,809		
dit Fee	1,000		
irectors' Fees	1,700		
nterest	1,972		

Debenture Interest	35,000		
Bonus to Staff	4,500		
Taxation	15,435		
Loss on sale of Investments	25,000		
Depreciation	20,000		
Net Profit	1,55,629		
Rs.	9,86,298	Rs.	9,86,298

Calculate the Company's taxable income from business after bearing in mind the following facts :—

1. Rs. 15,780 being the cost of erecting buildings on certain extensions of the Estate has been charged to Cultivation and Manufacturing Expenses.
2. General Charges include Rs. 500 given away as charity.
3. The amount of allowable depreciation may be taken as Rs. 12,750.

		Rs.
Profit as per Profit & Loss Account ...		1,55,629
Add Expenses disallowed :—		
Taxation ...	15,435	
Loss on sale of investments	25,000	
Depreciation ...	20,000	
Capital expenditure on Estate extension	15,780	
Charity ...	500	76,715
		2,32,344
Less Depreciation allowed ...	12,750	
Capital Profit ...	15,000	27,750
		2,04,594
Less 60% deemed to be agricultural income		1,22,756
Taxable income from business		81,838

N. B.—The capital loss of Rs. 25,000 will be set off against the capital profit of Rs. 15,000, but the balance of loss (Rs. 10,000) cannot be carried forward as it is less than Rs. 15,000.

5. *X* is a practising registered accountant who also runs a private accountancy training institute. He keeps his books on a cash basis and his summarised cash account for the year ended 31st March 1947 is given below.

To Balance b/d	9,654	By Office Expenses	4,150
" Audit Fees	14,750	" Institute Expenses	900
" Income from other accountancy work	5,475	" Personal Expenses	3,600
" Institute Fees	2,100	" Annual Registration Fee	32
" Examiner's Fee	645	" Life Insurance Premium	1,250
" Interest on Investments	4,400	" Income-Tax	2,500
" Rent from Property	4,200	" Motor-car purchased	3,450
		" " " Expenses	420
		" Insurance of Property	300
		" Cost of Bungalow purchased	18,000
		" Balance c/d	6,622
Rs.	41,224	Rs.	41,224

Bearing the following information in mind ascertain his taxable income from profession and also his total income for the previous year 1946-47 :—

1. Office Expenses include Rs. 108 for technical books and Rs. 65 for furniture purchased for the business.

2. One-third of the motor-car expenses are in respect of his profession.

3. He lives in a house of his own whose gross annual value may be taken to be Rs. 600.

4. His investments are all in government securities and port trust debentures.

5. Depreciation allowance for books and furniture used for purposes of his profession is Rs. 65.

Gross professional earnings :—			
1. Audit Fees	...	14,750	
2. Income from other accountancy work		5,475	
3. Institute Fees ...	...	2,100	
4. Examiner's Fee ...	...	645	22,970
Less admissible expenses :—			
1. Office Expenses ...	...	3,977	
2. Institute Expenses ...	...	900	
3. Registraion Fee ...	...	32	
4. Motor car Expenses ...	...	140	
5. Depreciation allowance	...	65	5114
Taxable income from profession		Rs.	17,856

Statement of Total Income

1. Interest on securities (in repsect of which income-tax amounting to Rs. 2,000 has been deducted at source)			6,400
2. Income from Property :			
Gross annual value (4200+600)		4,800	
Less $\frac{1}{6}$ for repairs	800		
Insurance	300	1,100	3,700
3. Income from profession ...			17,856
Total income		Rs.	27,956

V. Income from other Sources

Section 12 relates to the fifth and residuary head of income which is chargeable under the Act. Under this section tax is payable by an assessee in respect of income, profits and gains of every kind which may be included in his total income, and which are not included under any of the other four heads. The following are examples of income that may be taxable under this head ;—

1. Dividends from companies.
2. Royalties, commission, director's fees.
3. All interest other than interest on securities.
4. Ground rent.
5. Agricultural income that may be taxable.
6. Income from land not attached to a building (and of course not being agricultural income) *e. g.*, vacant lands in urban areas let out for storing materials.
7. Rent from sub-letting.
8. Remittances received by a wife resident in British India from her nonresident husband if they are not paid out of income included in husband's total income.

9. Salary or pension received from a foreign government or an Indian State.

Deductions. The taxable income from other sources is computed after making allowance for any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) which is incurred solely for the purpose of making such income.

Inadmissible expenses. All those expenses which are disallowed in computing the profits of a business, profession or vocation are also disallowed in determining the taxable income from other sources.

Machinery, etc., let on hire. When an assessee lets on hire machinery, plant or furniture belonging to him and also buildings (and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture), he is entitled to allowances for annual repairs, insurance premia, depreciation obsolescence in accordance with the provisions of section 10 (2).

Note :—When the commission of a managing agent of a company is shared, for an adequate consideration, between the managing agent and a third party, then each party's share is included in his individual assessment.

Dividends A dividend received by a shareholder is deemed to be his income of the previous year in which it is paid, credited or distributed, and for the purpose of computing his total income, the dividend actually received should be increased to such amount as would, if income-tax (but not super-tax) at the rate applicable to the total income of a company for the financial year in which the dividend is paid, credited or distributed were deducted therefrom, be equal to the amount of the dividend. Note that the relevant rate of tax at which the net dividend (*i. e.*, dividend actually received) is to be grossed up ***is not that of the financial year in which the corresponding profits of the company are assessed but that of the financial year in which the dividend is paid, credited or distributed.*** Note also that this tax addition to the net dividend is always to be made, even though the profits, out of which the dividend has been distributed, are converted into a loss when adjusted for the company's assessment (*e. g.*, by the admissible depreciation allowance), and therefore the company has to pay no tax thereon.

Where, however, only a portion of the company's profits are taxable because a part of them may have been derived from non-taxable sources such as agricultural income or interest from tax-free government securities, the amount of tax addition to the net dividend should be proportionate. But it must be remembered that the whole of the dividend is taxable in the hands of the shareholder, notwithstanding the fact that a part of it has been derived from non-taxable profits in the hands of the company.

It should be noted that a dividend paid without British India is deemed to be income accruing and arising in British India to the extent to which it has been paid out of profits subjected to income-tax in British India.

How to gross up net dividends.—The net dividend received by a shareholder from a company in British India should be grossed up in the following manner :—

(a) Where the full profits of the company are taxable, the net dividend received by a shareholder should be grossed up by applying the following formula.

$$\text{Net dividend} \times \frac{1}{1 - \frac{R}{192}}$$ where R is the company's rate of income-tax in pies per rupee. If we assume that the total income of a company is Rs. 192 and that the company's rate of income-tax is 30 pies per rupee, then the net dividend by the shareholder would be Rs. 162, the income-tax payable by the

company amounting to Rs. 30. Therefore for every Rs. 162 net dividend, the gross amount would be Rs. 192. Hence the above formula.

That if a shareholder receives Rs. 350 as a dividend from a company, whose profits are taxable in full, the gross dividend would be Rs. 414-13-0.

(b) *Where only a portion of the company's profits is taxable,* the net dividend received by a shareholder should be grossed up by applying the following formula :—

$$\text{Net dividend} \times \frac{1}{1-\left(\frac{X}{100}\times\frac{R}{192}\right)}$$

where X is the percentage of the company's profits which has borne income-tax and R is the company's rate of income-tax in pies per rupee.

Let us suppose that the profits of a company amount to Rs. 100, 30 per cent. of which are taxable, the balance being non-taxable. Then the amount of income-tax on Rs. 30 payable by the company at 60 pies per rupee is Rs. 9-6-0, and the net dividend in the hands of the shareholders would be Rs. 90-10-0. Therefore for every Rs. 90-10-0 net dividend (when only 30 per cent. of the company's profits are taxable and when the rate of company's income-tax is 60 pies per rupee) the gross dividend would be Rs. 100. Hence the above formula.

For example suppose a shareholder receives Rs. 350 as dividend from a company, 40 per cent. of whose profits are taxable, then the gross dividend would be Rs. 400, and the amount of income-tax for which he would get credit in his own assessment would be Rs. 50.

Note.—If a shareholder receives a dividend from a company whose profits are not chargeable to Indian income-tax, either because the whole profits are derived from non-taxable sources or because the company is a foreign company having no British Indian income, then it would not be necessary to gross up the net dividend, as the net dividend itself would be included in the total income of the shareholder.

Test Questions

1. In what circumstances are the following items allowed as a deduction in computing the taxable income from business :—Repairs ; Insurance premiums ; Interest ; Legal charges ; Depreciation of Investments ?

(Agra B. Com. 1943)

2. What expenditure is expressly disallowed in computing the taxable income from business ?

3. Under what circumstances is interest or salary payable without British India not admissible in computing the business income of an assessee ?

4. State the law relating to assessment of the dividend income.

5. Define net dividend and gross dividend. How do you gross up net dividends ?

6. The managing agents of a company ask you to compute the company's income for the purpose of preparing the return of income to be filed with the I. T. O. Explain clearly with a *pro forma* Profit & Loss Account how you would proceed to do so.

7. How will you treat, for purposes of income-tax, the following expenses of a company ?

(a) Painting and redecorating the drawing room of the managing directors ;
(b) New fireplace and mantelpiece in the dining room of the managing director ;
(c) Motor-car overhauling expenses ;
(d) Construction of a hard tennis court ;
(e) Travelling to branch offices all over India by plane.

(Agra M. Com, 1948)

CHAPTER 8

COMPUTATION OF TAXABLE INCOME (3)

VI. Capital Gains

The Indian Income-Tax Amendment Act of 1947 has made a fundamental change in the income-tax law in that an assessee is now required to pay income-tax (not super-tax) under the head 'capital Gains' in respect of any profits arising from the sale, exchange or transfer of a capital asset effected after 31st March 1946.

The term 'Capital Asset' for this purpose has been defined by section 2 (4A), and it includes property of any kind other than agricultural land held by an assessee, whether or not connected with his business, profession or vocation. But such asset will not include (i) any stock in trade, consumable stores or raw materials held for the purposes of business; or (ii) personal effects, i. e., movable property including wearing apparel, jewellery and furniture held for personal use by the assessee or any member of his family dependent upon him. Thus property includes not only immovable property such as houses but also movable property such as securities, shares etc.

Exemptions. Profits made on capital assets are chargeable to income-tax subject to the following exemptions:—

1. Only such capital gains are taxable as arise from the sale, exchange or transfer of an asset effected after 31st March 1946, any capital profit made prior to that date being ignored.

2. No tax is payable on capital gains if they do not exceed Rs. 15,000, nor are they to be included in the total income. That is to say, capital gains not exceeding Rs. 15,000 are to be ignored.

3. No tax is payable by an assessee on profits or gains arising from the sale, exchange or transfer of any property, the income of which is chargeable under section 9 (i. e., income from property) if such property has been in the possession of the assessee or his parent for a period not less than seven years before the date of sale.

4. Transfer of capital assets in the following cases shall not be considered as sale, exchange or transfer, and hence any profit made thereon shall not be included in the total income:—

(a) Transfer by way of compulsory acquisition of property for public purposes; or

(b) Transfer by way of distribution of capital assets on the total or partial distribution of Hindu undivided family; or

(c) Transfer on the dissolution of a firm or other association of persons; or

(d) Transfer on the liquidation of a company; or

(e) Transfer under a deed of gift, bequest, will or on irrevocable trust; or

(f) Transfer of a capital asset by a company to a subsidiary company the whole of the share capital of which is held by the parent company or by the nominees thereof, provided the subsidiary company resident in British India and is registered under the Indian Companies Act,

Computation of Capital Gains. The amount of taxable capital gains is computed after making the following deductions from the full amount of consideration for the sale, exchange or transfer of a capital asset :—

(a) Expenditure incurred solely in connection with the sale, exchange or transfer ; and

(b) Actual cost to the assessee of the asset including any expenditure of a capital nature incurred by him in making any additions or alterations but excluding any expenditure in respect of which any allowance is admissible under the provisions of sections 8, 9, 10 and 12.

Note. Where any depreciation has been claimed on an asset in the past, the actual cost of the asset to the assessee shall be its written–down value which, according to section 10, means the actual cost (increased by all additions and diminished by all sales) minus total depreciation allowed to date.

The assessee, if he satisfies the Income-Tax Officer, may substitute the fair market value of the asset for the actual cost in the case of assets acquired by him before 1st January 1939. Such fair market value of the asset will be regarded as the actual cost to the assessee and will be reduced by the amount of depreciation, if any, and increased by all additions and diminished by all sales after the said date.

If a person, with whom the assessee is directly or indirectly connected, acquires a capital asset from the assessee and if such sale, exchange or transfer has been affected with the object of avoidance of tax, the Income-Tax Officer may, with the prior approval of the Inspecting Assistant Commissioner, regard the 'fair market value' of the asset on that date as the full value of consideration and may compute capital gains accordingly.

Computation of Tax on Capital Gains. Under section 17 (6), where the total income of an assessee (not being a company) includes any income taxable under the head "Capital gains", the tax including super-tax payable by him on his total income will be :—

(a) Income-tax and super-tax payable on his total income as reduced by such capital gains, had such reduced income been his total income **plus**,

(b) Income-tax on the whole of such capital gains at the following rates :—

Where capital gains	Rate per rupee
exceed Rs. 15,000 but do not exceed Rs. 50,000	one anna
exceed Rs. 50,000 but do not exceed Rs. 2,00,000	two annas
exceed Rs. 2,00,000 but do not exceed Rs. 5,00,000	three annas
exceed Rs. 5,00,000 but do not exceed Rs. 10,00,000	four annas
exceed Rs. 10,00,000	five annas

A marginal relief is, however, provided in cases where capital gains ve exceeded a certain limit and income-tax thereon is payable at a higher t, the amount of income-tax so payable shall be reduced so as not to ceed—

(a) the amount which would have been payable if the amount of such capital gains had not exceeded that limit **plus**

(b) one-half of the amount by which the amount of such capital gains exceeds that limit.

Where the total income of a company includes income chargeable under the head 'capital Gains', income-tax will be paid on the whole of the total income at the maximum rate of income-tax ; while the super tax payable by the company shall be reduced by the amount computed on that part of its total income which consists of capital gains at the rate of super-tax (excluding the rate of additional super-tax, if any) specified by the annual Finance Act fixing the rates of super-tax for that year,

Illustrations

1. The taxable income of X for the year ended 31st March 1947 consisted of Rs. 3,000 each from salary, interest on securities, property, business and dividends (gross) and also Rs. 3,000 capital gains. What is his tax liability for the assessment year 1947-48 ?

As capital profits which do not exceed Rs. 15,000 are totally ignored, the total income of X is Rs. 15,000 ; and after giving the earned income allowance of Rs. 1,200 in respect of salary and business income, the assessable income is Rs. 13,800. He will therefore have to pay income-tax amounting to Rs. 1,675 less the amount of income-tax deducted at source on salary, interest on securities and dividends.

2. The taxable income of X for the year ended 31st March 1947 consisted of Rs, 10,000 from property and Rs. 15,000 from business and also capital gains amounting to Rs. 25,000.

He paid Rs. 3,000 as life insurance premium on a policy for Rs. 25,000 Calculate his tax liability for the assessment year 1947–48.

His total income is Rs. 50,000 ; and after making an allowance of Rs. 3,000 for earned income from business, the assessable income is Rs. 47,000 on which income-tax will be calculated as follows :—

On Rs. 22,000	...	4,125 0 0
On capital gains of Rs. 25,000	...	1,562 8 0
		5,687 8 0
Average rate of income-tax 23-23 pies per rupee		
Amount of rebate on Rs. 2,500 for premium		302 8 0
	Tax payable	Rs, 5,385 0 0

3. For the year ended 31st December 1946, the taxable income of X from business amounted to Rs. 24,000, and he made a capital gain of Rs. 50,400 by selling a capital asset on 15th July 1946. What is his tax liability for the assessment year 1947–48 ?

His total income for the previous year ended 31st December 1946 is Rs. 74,400 ; and after making an allowance of Rs. 4,000 on account of earned income, the assessable income comes to Rs. 70,400 on which the income-tax will be as follows :—

On Rs. 20,000	...	3,500 0 0
On capital gains of Rs. 50,400	...	3,325 0 0
	Tax payable	Rs. 6,825 0 0

The income-tax on the capital gains has been computed as follows :

On Rs. 50,000 at one anna per rupee	3,125
One-half of Rs. 400 being excess over Rs. 50,000	200
	Rs, 3,325

4. The taxable income from business of X Ltd. for the year ended 31st December 1946 is Rs. 50,000 ; and it also made a capital gain of Rs. 50,000 on 1st October 1946. How much income-tax and super-tax will it be required to pay for the assessment year 1947-48 ?

The total income of the company for the assessment year 1947-48 is Rs. 1,00,000 on which it will pay income-tax at 5 annas in the rupee. It will also have to pay super-tax at the rates prescribed as given in Appendix B. How the super-tax payable by a company is computed will be explained and illustrated in a subsequent chapter.

Set-off of Capital Losses. Under section 24 (2A), where a loss sustained is a loss falling under the head "Capital gains," such loss shall not be set off except against any profits and gains falling under that head.

Carry-forward of Capital Losses. Section 24 (2B) allows the carry-forward of losses incurred under the head "Capital gains." If owing to the inadequacy of capital gains, the loss cannot be wholly set off the portion not set off can be carried forward to the following year and set off against capital gains for that year, and if it cannot be so set off it can be carried forward to the following year and so on. No such loss can be carried forward for more than six years.

It must be noted that where the capital loss sustained in any year does not exceed Rs 15,000 it cannot be carried forward.

Replacement of Capital Assets. Where a capital asset is sold which was used for purposes of business immediately before such sale, and where a capital asset is sold which in the two years immediately preceding such sale was used for the residence of the assessee or his parent, and where the assessee has purchased for the same purpose a new asset within a period of one year before or after the date of sale, tax on such capital gain may, at the option of assessee, if he so elects in writing, be computed as follows :—

(a) If the amount of the capital gain is greater than the cost of the new asset, the difference between the amount of the capital gain and the cost of the new asset shall be charged as the income of the previous year. But for computing the depreciation and obsolescence allowance in respect of the new asset, its cost or the written-down value shall be nil.

(b) If the amount of the capital gain is equal to or less than the cost of the new asset, the capital gain shall not be charged at all. But for computing the capital gain of the new asset whenever it is to be sold for computing the depreciation and obsolescence in respect of the new asset, its cost or the written-down value shall be reduced by the amount of capital gain.

Illustrations

1. If the capital gain on the sale of a capital asset amounts to Rs. 80,000 and the cost of the new asset purchased for the same purpose is Rs 50,000 the difference of these two figures (namely Rs. 30,000) will be included in the total income. But in arriving at the capital profit on the sale of the new asset, its cost shall be taken to be nil, i. e., if this new asset is sold for Rs. 60,000, then the capital gain on this asset will be Rs. 60,000 (i. e. Rs. 60,000 minus the cost of the asset which is zero.)

2. If the capital gain on the sale of a capital asset amounts to Rs. 80,000 and the cost of the new asset purchased for the same purpose is Rs. 1,00,000, then the capital profit of Rs. 80,000 shall not be taxed at all. But in arriving at the capital profit on the sale of the new asset, its cost shall be taken to be Rs. 1,00,000 *minus* Rs. 80,000 or Rs. 20,000 ; and should this new asset realise Rs. 1,20,000, the capital gain thereon will be Rs. 1,00,000.

Test Questions

1. In connection with the taxation of capital gains, define the term 'Capital Asset.'
2. What are capital gains and how are they computed ?
3. Which capital gains of an assessee are liable to tax ?
4. How is tax on capital gains computed ?
5. For the year ended 31st March 1947, a person had the taxable income of Rs. 2,000 under each of the five heads of income and also Rs. 20,000 capital gains. State clearly how his tax liability for the assessment year 1947–48 will be ascertained.

CHAPTER 9

CAPITAL AND REVENUE

In computing the taxable income from business and other sources, the distinction between capital and revenue as regards expenditure, profits, and losses is of vital importance ; and the general principles governing the distinction must be carefully understood.

1. Capital and Revenue Expenditure

It is not possible to lay down any hard and fast rules for making distinction between capital and revenue expenditure, for the same expenditure may be capital in one case and revenue in another, or it may be partly capital and partly revenue. An item of expenditure cannot be properly allocated between capital and revenue until all the facts of the case are known. The following rules may, however, serve as a guide for distinguishing between capital expenditure and revenue expenditure :—

Capital Expenditure. Any expenditure is capital expenditure when it is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade. The advantage may be of a negative nature, e. g., relief from a burdensome asset. What is important is that the expenses must be incurred with a view to i. e., with the object of, securing an advantage which may or may not accrue. It is the object a one, and not the result, that counts. Thus an expenditure incurred in obtaining a licence, though none is used, or to secure a sole agency, though none is granted, is capital expenditure.

Any expenditure which is incurred for the following purposes is capital expenditure :—

(a) For acquiring fixed assets such as land, buildings, machinery, furniture, etc., which are held for use in the business and not for resale. The cost of a fixed asset would include all expenditure necessary up to the time the asset become ready for use. Thus the cost of land purchased would include the price paid for it to the seller together with all legal charges and broker's commission, if any ; similarly the cost of acquisition of machinery would include the purchase price, freight, import duty, clearing charges, carriage, octroi, cartage and erection charges.

(b) For retaining a capital asset, e. g., legal expenses incurred by a company for defending a suit brought by a village proprietary body to reject the company from certain slate quarries, which were its capital asset, are capital expenditure.

(c) For improving and extending existing fixed assets, e. g., the cost of making additions to buildings, machinery, furniture, etc. or the cost of making any other improvements to such assets. A person who was the promoter, managing director and principal shareholder of a company made a gift of Rs. 3 lakhs to the company when it was in financial difficulties, and this payment was held to be capital expenditure because it had enhanced the business reputation (a capital asset) of the payer.

(d) For increasing in any way the income-earning capacity of a business, e. g., the cost of removing the business to more commodious and better situated premises.

(e) For raising capital monies for purposes of the business such as brokerage and commission paid for procuring loans.

Revenue Expenditure. Any expenditure which is incurred for the following purposes is revenue expenditure :—

(a) For purchasing assets intended for resale at a profit or for being made into saleable goods, such as the cost of goods, raw materials and stores.

(b) For maintaining capital assets in good working order, e. g., repairs and renewals of buildings, machinery, furniture, etc., or the cost of spare parts of machinery.

(c) For meeting the day-to-day expenses of carrying on a business such as rent, taxes, salaries, wages, carriage, etc.

Difficulty may often be experienced in deciding whether a particular item of expenditure should be treated as capital or revenue ; but this difficulty may be easily removed by asking the following questions :—

1. Does the expenditure result in the acquisition or retention of a capital asset ?
2. Is there an addition or improvement to a fixed asset ?
3. Has it in any way improved the income-producing capacity of the business ?
4. Has it been incurred to raise any capital sums for the business ?

If the answer to any of these questions is in the affirmative, the expenditure is capital, but if the answer is in the negative, the expenditure is revenue.

There are certain expenses (such as purchases of raw materials and stores, wages and salaries, repairs, legal charges, advertising, brokerage, commission, etc.) that are usually of a revenue nature. But it does not mean that they are always so. The following are examples of expenses, which are usually revenue but which under certain circumstances become capital :—

1. *Raw Materials and Stores.* The cost of any raw materials and stores consumed in the making of a fixed asset must be regarded as capital expenditure, and must be transferred from the account of raw materials and stores to the debit of the account of that particular fixed asset.

Wages and Salaries. Wages and salaries of workmen employed in the construction of any fixed asset are capital expenditure and must be treated as part of the cost of the asset. For example, if a mill company decides to make additions to its factory buildings, and, instead of giving the construction work to an outside contractor, employs its own men for the purpose, the wages and salaries of such persons for the period they are engaged on this work are not revenue expenditure but must be treated as capital expenditure and debited to the Buildings Account. Similarly if an engineering firm manufactures a machine for its own use, the wages and salaries of persons employed on this work are capital expenditure and must be treated as part of the cost of that particular machine.

3. *Carriage and Freight.* Carriage and freight in connection with the acquisition of a fixed asset are capital expenditure.

4. *Repairs.* If a secondhand fixed asset is purchased, the cost of immediate repairs in order to put it into an efficient state is capital expenditure.

5. *Legal Charges.* Legal expenses incurred in connection with the purchases of fixed assets such as land, buildings, patents, etc., are capital expenditure, so are the legal expenses incurred in order to retain a fixed asset.

6. *Advertising.* Expenditure on ordinary advertising necessary to maintain sales is revenue, but the cost of special advertising undertaken for the purpose of introducing a new line of goods may be treated as capital expenditure because its benefit will extend to future years.

7. *Development Expenditure.* Certain concerns, such as collieries, railway companies, electric supply companies, mining companies, tea and rubber plantations, etc., require a very long period of development before they can begin to earn income. All expenditure necessarily incurred during that period is called development expenditure and is treated as capital, although it consists of items such as wages, salaries, rent taxes and so on which are all of a revenue nature.

Apportionment between Capital and Revenue. An item of expenditure is usually either capital or revenue but it may sometimes happen that it cannot be properly allocated in its entirety to either capital or revenue, because it partakes of the nature of both, as for example, the combined cost of repairs, renewals, alterations and extensions of a fixed asset such as buildings or machinery.

In such a case it will be necessary to split the particular expenditure into its capital and revenue, parts, namely, so much capital and so much revenue. This will be done by finding out how much of the expenditure really represents the cost of improvements or additions and how much of it is in the nature of pure repairs. The former amount will be capital expenditure and the latter amount revenue.

The question whether a particular item of expenditure is capital or revenue assumes special significance in income-tax assessments, and there are a number of Important cases decided by High Courts in India in that connection. It is indeed sometimes difficult to draw a line of demarcation between what is capital expenditure and what is revenue expenditure as will be apparent from the following example.

The Central India Spinning, Weaving & Manufacturing Co., Ltd., Nagpur, incurred an expense of Rs. 2,577 in connection with a suit which it had brought against the Binod Mills, Ltd., Ujjain, to restrain the latter company from using a trade mark to which the former company had acquired an exclusive right by long user. The former company as the assessee in income-tax proceedings claimed this expenditure as revenue expenditure. Its claim was rejected by the Income-Tax Officer and Appellate Assistant Commissioner of Income-Tax on the ground that it was capital expenditure being a non-recurring outlay for retaining a capital asset. That view was upheld by the Income-Tax Appellate Tribunal on the ground that the trade mark was a capital asset of the assessee company, and that consequently the legal expenses incurred for protecting it against infringement was capital expenditure. On a reference to the Nagpur High Court it was finally decided that the expenditure in question was a revenue expenditure. It means that this expenditure was regarded as revenue by the assessee company, as capital by the Income-Tax authorities and ultimately as revenue by the High Court, and the arguments advanced by each of the three parties were as follows :—

1. The assessee company contended that the civil suit against the Binod Mills, Ltd., was necessitated by the infringement of the assessees' trade mark, and that therefore the legal expense was incurred for arresting losses or reduction of profits which might have resulted in the goods of the Binod Mills, Ltd., being accepted as those of the assessee company. It means that the expenditure incurred by the assessee company was directly connected with its trade, was incurred for the purpose of preventing their profits from being reduced by the illegal use of its trade mark by another company, and it was therefore revenue expenditure.

2. The Income-Tax Appellate Tribunal held that the trade mark was a capital asset of the assessee company, and, consequently the legal expense incurred for protecting it against infringement was capital expenditure.

3. The Nagpur High Court finally decided that the expenditure was revenue expenditure and not capital expenditure, because the assessee had to displace a counterfeit trade mark which prejudicially affected the sale of its goods. *The threat was not directed towards the capital of the company but towards its trade.* The capital is concerned with production, while the trade is concerned with selling, with a view to profit, the goods which the assessee has manufactured. The counterfeit trade mark introduced into the market by the assessee's unscrupulous rival must be deemed to have had serious effect on the volume of the sale of the goods manufactured by the assessee. The object of launching legal proceedings against the competitor was to restore the trade to its original standard. It was not merely a voluntary act intended to improve the sales but an act necessary to prevent an actual loss in the sales. The drop in the sales impaired directly the dividend earning power of the Company not to speak of its status or reputation, and had nothing to do with its capacity to manufacture them and had no bearing on the capital. The assessee was hit not as an industrialist but as a trader; the expulsion of the counterfeit trade mark from the market by means of litigation in Court did not make any addition to the capital of the company or bring any additional advantage but only removed an impediment in the way of earning legitimate profits by sale of the goods produced by the assessee. In view of this the legal expense of Rs. 2,577 was held to be revenue expenditure.

It must be pointed out that expenditure incurred in defending a capital asset may in some cases be expenditure of a capital nature, as, for instance, the legal expense incurred by the Kangra Valley Slate Co., Ltd. for defending a suit brought by a village proprietary body to eject the company from certain slate quarries, was held by the Lahore High Court to be capital expenditure. An attack on a trade mark by infringement was, however, regarded not as an attack on a capital asset but rather as an attack on existing and future trade and on the value of stock-in-trade, existing and in course of manufacture and to be manufactured in the future. Given below are a few more examples of capital and revenue expenditure :—

1. A company established a pension fund for its staff. The fund was constituted by a trust deed which provided that members should contribute a percentage of their salaries to the fund, that the company should contribute an amount equal to half the contributions of the members, and that the company should contribute a sum of £ 31,784 to form nucleus of the fund. The company contributed that sum of £ 31,784 out of current profits. This initial contribution was held to be capital expenditure on the ground that the payment of a large sum of £ 31,784 by the company which it was not under any liability to make was either withdrawal of capital from the business for the purposes of the fund, or capital employed in creating an asset or advantage in the business.

2. A company incurred expenditure in defending, as lessee of certain land in a village, the suit for possession and injunction instituted by the lessors. The legal expenses thus incurred by the company were held to be capital expenditure, because the company had secured this land by a perpetual lease for the purpose of quarrying slate, the land was therefore clearly part of its capital, and any attack made on that capital if successful would have resulted in its being a loss to the company. Consequently it could be said that it was capital expenditure in the sense that by expending money in defending the suit once and for all it ensured the land permanently to the company.

3. A person, who was a shareholder in a company and carried on extensive money-lending business, advanced a loan of Rs. 10 lakhs to the company at a time when it was in serious financial difficulties. Some of the

other shareholders brought a suit against him that the loan of Rs. 10 lakhs was only a part of the promise made in an alleged agreement under which he was to finance the company and that he had failed to implement his promise. He was therefore sought to be made liable to the extent of Rs. 60 lakhs as damages for breach of his agreement. The suit was eventually dismissed and the expenses incurred in defending the suit were held to be revenue expenditure on the ground that the money which a banker or a moneylender employed in his business was his stock-in-trade and the money expended for the purpose of insuring the stock-in-trade of a business must be considered to be expenditure in the nature of revenue expenditure.

4. A brewery company spent money on publishing anti-prohibition literature just before a poll in which the issue was whether there should be prohibition or not. This exenditure was held to be capital expenditure on the ground that it had no direct bearing on the profits and gains of the business but was intended to secure an enduring benefit of a capital nature.

Capitalised Expenditure. Where a certain revenue expenditure is of such a nature that its benefit is not completely exhausted in the year in which it is incurred or where a revenue expenditure is of a non-recurring and special nature and large in amount, it may not be completely writen off in the year in which it is incurred, but it may be spread over a number of years, a proportionate amount being charged to each year. The balance of such expenditure which is carried forward to subsequent years is known as *capitalised expenditure* or *deferred revenue expenditure*, which appears in the Balance Sheet as asset until completely written off.

2. Capital and Revenue Payments

The difference between expenditure and payments must be carefully noted. Expenditure is the full amount actually incurred whether paid or not; whilst payments refer to the amounts actually paid. Thus, a capital payment is an amount actually paid on account of some capital expenditure, and a revenue payment is an amount actually paid on account of some revenue expenditure.

If machinery is purchased from X for Rs. 20,000 by paying Rs. 10,000 in cash and promising to pay the balance in six month's time, Rs. 20,000 is capital expenditure but only Rs. 10,000 is a capital payment. Similarly if goods are purchased from Y as to Rs. 10,000 for cash and Rs. 10,000 on credit, Rs. 20,000 is revenue expenditure but only Rs. 10,000 is a revenue payment.

3. Capital and Revenue Profits

In order to prepare the final accounts of a business correctly, the distinction between capital and revenue profit is also important; and this distinction depends very largely upon the source from which a particular profit has been derived.

Capital Profit. This means a profit made on the sale of a fixed asset or a profit earned on securing capital for a business. For example, if a building standing in the books at Rs. 12,000 is sold for Rs. 15,000, the profit of Rs. 3,000 thus made is a capital profit, or if a limited company raises a share capital of Rs. 10,00,000 at a premium of Rs. 10,000 such premium is a capital profit.

Revenue Profit. This is the profit made by trading, e. g., profit on sale of goods, income from investments, commission earned, discounts received, rent received, interest earned, and so on.

4. Capital and Revenue Receipts

It is important to remember the difference between profits and receipts. Profits are the amounts actually earned whether received or not: while receipts are the amounts actually received. Thus, a capital receipt is an amount actually received either on account of some capital profit or on account of the sale proceeds of a capital asset or on account of capital introduced into the business, and a revenue receipt is an amount actually received on account of some revenue profit or on account of the sale proceeds of some floating asset.

The following are some examples of capital and revenue profits and receipts:—

1. A cement company had, among its objects, the acquisition of and dealing in shares which might promote the interest of the company, and the lending and investing of money of the company. A certain sum representing profits made by it on sale of some shares which were purchased by it out of surplus capital from a sister concern was held to be revenue profit, because the transaction in the purchase and sale of shares was a business transaction.

2. A firm acted as agents and on the termination of the agency they were paid a certain lump sum of money by their principals as compensation for the loss of their agency. The money so received is a capital profit, as it is a receipt *in* respect of a capital asset in the nature of goodwill.

3. A limited company, as buyers, entered into a contract with another company, as sellers, for the supply by the latter of certain chemical salts to be sold for use as agricultural chemical. When the contract has three years still to run, the vendor company wished to terminate it, and it was accordingly agreed that they should be entitled to do so on paying the buyer company £4,750. This amount in the hands of the buyer company is a revenue profit which the recipient would or might have made under the contract had it not been terminated.

4. X was the managing director of a company which had agreed to remunerate him by a percentage share of its profits. Later on it was felt that the agreement was not in the best interests of the company, and it was therefore agreed that it should be terminated by paying X £4,000 as compensation for the loss of his right to future remuneration. This amount of £4,000 in the hands of X was held to be a capital receipt, since it was received by him, not under a contract of employment or as remuneration for services rendered or to be rendered, but as compensation for giving up a right to remuneration.

5. X Company, which was carrying on the business of producers of plays, purchased the production of a play for Rs. 1,000 and was granted the sole license to perform the play for a period of five years. As the film rights in the play had already been sold by the licensor to another company, the X Company brought an action against the licensor for damages and was awarded Rs. 5,000 as damages. As the measure of the damages was really the loss of profits which the X Company suffered by the breach of contract, it was a revenue profit.

6. The publishers of a literary work paid the author £150 for a licence to publish an edition of the book. £150 in the hands of the author was regarded as a capital receipt as it represented the sale proceeds of the copyright.

7. Where a certain sum of money was paid to person in settlement of bona fide claim on his part to be entitled to an interest in the capital of the business, the *money so received* was a capital receipt.

8. X was a director of a company. He was thinking of resigning his position but the company was anxious to retain his services and it was agreed that he should remain a director on a remuneration of £ 400 per year and a

lump sum payment of £ 45,000 in two instalments. It was held that X's continuance of the office of director was the essence of the bargain between him and the company, that the transaction necessarily involved an agreement to continue to render services, and the money paid as the consideration for that bargain was a profit from X's directorship, and it was therefore a revenue profit.

9. A limited company took out a policy of insurance for £ 15,000 for its own benefit to cover loss ensuing on the death or injury by accident of a director, whose special qualifications and experience were of value to the company. The director was killed by accident and the sum assured was received by the company. It was held that the sum of Rs. 15,000 must be treated as a revenue receipt. The director concerned was rendering services which greatly increased the company's revenue and the sole purpose of insuring was to protect the company against an expected fall in income if his services were no longer available. The expected fall in revenue was reflected in the amount of the policy.

10. Sums paid by mutual insurance society to a member during permanent disablement through accident are revenue receipts in the hands of the recipient, notwithstanding that the member continues to pay premiums while in receipt of benefit.

11. A landlord leased out a plot of land to mining company in consideration of receiving a salami of Rs. 1,800 and an annual rent of Rs. 100. The amount of the salami was held to be a capital receipt as it represented the price for parting with the land, while the annual rent, being in the nature of compensation which the lessee paid the lessor for that species of occupation which the contract between them allowed, was a revenue profit.

Transactions by which a lump sum is paid under the name of salami for the granting of a lease are more in the nature of an out and out sale of property and the sum received by the lessor is therefore a capital receipt. There is a vital distinction between a single payment made at the time of the settlement of the land and recurring payments made during the period of its enjoyment by the lessee. It cannot, however, be laid down as a hard and fast rule that a salami is always a capital receipt in the hands of the lessor. It may be that in some cases the evidence might show that the parties fixed the salami or nazrana as advance payment of rent, and in those cases the salami would be a revenue receipt. Consequently whether salami is a capital receipt or revenue receipt can only be determined after a full investigation of all the facts relating to the settlement for which the salami or nazrana is paid.

12. A bank sustained a loss of Rs. 8,790 by reason of embezzlement on the part of an employee. Later on it recovered from the heirs of the employee the full amount of Rs. 8,790 but it had to spend Rs. 4,053 on legal charges in doing so. It was held that in the circumstances of the case the sum of Rs. 4,737 (i. e., Rs. 8,790—Rs. 4,053) was a revenue profit, as the matter was one directly connected with the trade.

5. Capital and Revenue Losses

Like capital and revenue profits, the distinction between capital and revenue losses is also important. This distinction depends on how a particular loss has been made.

Capital Loss. This is a loss made on the sale of a fixed asset or a loss incurred in connection with the raising of capital for the business. For example, if a building standing in the books at Rs. 12,000 is sold for Rs. 10,000 the loss of Rs. 2,000 thus sustained is a capital loss, or the discount on shares and debentures issued by a company is a capital loss.

Revenue Loss. This is the loss incurred in trading operations such as loss on the sale of goods.

The following are some of the examples of capital and revenue losses :—

1. Sums embezzled by the servants of a business are a revenue loss, because they are a loss incidental to the conduct of the business.

2. Where a partner took over some book debts at the dissolution of a firm, and those debts turned out to be irrecoverable, the loss sustained was not one incurred as a trading loss, but was a capital loss.

3. The manager of a company embezzled a sum of £12,625, and it was held that the loss was of a capital nature. The manager was authorised to draw on the company's banking account. Once the company's assets are converted in money, it becomes portion of its capital for reinvestment, and any withdrawal of such capital, whether autnorised or not, is a capital loss.

4. A firm carried on business in cloth, yarn and money-lending. It deposited with an oil company Rs. 50,000 in consideration of being appointed organising agents of the oil company. Through the failure of the company a part of this deposit was lost ; and it was held that the loss was of a capital nature. The deposit was not a loan made in the course of carrying on the business of organising agents or in the course of the business of a money-lender. It was exacted by the company as a condition of the firm being given an agency which it hoped to manage profitably ; the purpose of being permitted to engage in such a business must be considered to be a purpose of securing an enduring benefit of a capital nature, and the deposit amount could not be regarded as an expenditure made in the course of carrying on an existing agency or any other business. The loss of the deposit was therefore a loss of capital.

5. Where a person residing in British India carries on a money-lending business at a place outside British India where a different currency prevails, the loss incurred by him owing to variation in the rate of exchange is a revenue loss, because it is directly connected with trading.

6. A firm's sources of income were import and sale of piecegoods, commission agency, interest on securities, dividends and property. Certain dacoits armed with pistols with the assistance of an employee of the firm entered the firm's office where the cashier and the munim were counting and totalling the realisations of the day and carried away Rs. 14,400 by force. There was no evidence to show that the firm carried on money-lending business or banking though it used to receive moneys from others on interest and use the same in its business. In view of the nature of the firm's business the money carried away could not be regarded as its stock-in-trade. The loss was therefore a loss of capital.

Test Questions

1. What criteria would you apply in distinguishing capital expenditure from revenue ?

Discuss the admissibility of the following claims for expenses against business profits :—

(a) Legal charges incurred in filing a suit for infringement of trade mark

(b) Legal charges incurred in defending a pre-emption suit in respect of the business premises owned by the assessee.

(c) Initial expenses of registration of a trade mark.

(d) Loss of cash sent to the bank for credit in current account, the cash being snatched away by a thief from the employee.

(e) Nazrana paid for a lease of land.

2. Explain and illustrate the difference *(a)* between capital profit and revenue profit ; *(b)* between capital loss and revenue loss.

3. State, with reasons, whether the following transactions of a limited company are capital or revenue :—

(a) A person was injured by the company's motor-car and Rs. 2,000 was paid to him as compensation.

(b) Investments purchased several years ago for Rs. 2,50,000 were sold for Rs. 3,50,000.

(c) Rs. 80,000 expended on the construction of a High School for the children of the company's workers, and Rs. 25,000 received from the Provincial Government as grant-in-aid for this purpose.

(d) The company's electric installation, standing in the books at Rs. 15,700 was completely destroyed by lightning, and Rs. 56,000 was spent on its rebuilding.

4. State, with reasons, whether the following receipts are capital or revenue :—

(a) Amount received in commutation of pension.

(b) A person, not belonging to the Police Department, receives a reward for tracing an absconder.

(c) A reward received by a competitor in an essay competition.

(d) X, an agent of Y, receives a lump sum from Y as compensation for the termination of agency.

5. From the decided cases, can you bring out the distinction between Capital and Revenue for purposes of taxation ? *(Agra M. Com. 1948).*

CHAPTER 10.

DEPRECIATION AND OBSOLESCENCE

Depreciation of a fixed asset is the permanent reduction in its value. This loss in value may be due to wear and tear (i. e., use), lapse of time, exhaustion of the subject-matter, or accident. But for income-tax purposes, allowance is made only for depreciation caused by wear and tear.

According to section 10 (2) (vi) of the Indian Income-Tax Act, depreciation is allowed at the prescribed rates on the written-down value only for buildings, machinery, plant and furniture, *which are the property of the assessee* and *which are used for purposes of business, profession or vocation.* In the case of ocean-going ships, depreciation is, however, allowed on the original cost instead of on the written-down value.

A building is deemed to be used for business purposes when it is used for the production of commodities, or for storage, or for distribution, or for administration, or as a welfare building. The term plant includes vehicles, books, scientific apparatus and surgical equipment.

It is to be particularly noted that depreciation is allowed only on account of user (active or passive) and not on account of non-user. That is why no such allowance is permissible in the case of an asset lying idle. An asset will not be regarded as lying idle when it is actually used or when it is intended to be used. For example, if some machinery purchased is not yet erected in the factory but is lying in store, then such machinery is lying idle.

If the user is partial, then the depreciation allowance will also be partial, as provided in section 10 (3). The term 'partial user' dos not mean partial in relation to time, but partial in relation to purp'se. Thus, if an asset (say a motor-car) is used partly for business and partly for the private use of the proprietor, then the depreciation allowance in respect of the motor-car will be only partial. But if an asset is purchased in the middle of the accounting year, depreciation thereon will be allowed in full and not according to the time. If an asset is sold during the year, both the vendor and the purchaser would be entitled in their respective assessments to the full and not merely a proportionate depreciation allowance.

Who is entitled to depreciation ? It is the owner that is entitled to claim allowance for depreciation. A leasee, who carries on business, having taken on lease buildings or machinery or plant, is not entitled to claim the depreciation allowance.

Where an assessee lets on hire machinery, plant or furniture belonging to him and also buildings, and the letting of buildings is inseparable from the letting of the said machinery, plant or furniture, depreciation is allowed for such machinery, plant, furniture and buildings to the lessor.

Replacement instead of depreciation. In the following two cases, the cost of replacement may be claimed as an allowance in place of depreciation :—

(a) In the case of furniture, if the assessee so desires, he may claim the cost of replacement instead of depreciation, but such replacement cost should not include the cost of any improvement.

(b) In the case of assessees, drawing income from railway and tramways (not being electric tramways), they have the option to claim actual expenses incurred in the accounting year on repair, replacement and renewals in place of the depreciation allowance.

Initial Depreciation. The Indian Income-Tax Amendment Act of 1946 has made provision for the grant of the following initial depreciation on account of *new* buildings and machinery or plant *in respect of* the year of erection or installation.

(a) In the case of buildings, the erection of which is begun and completed between 1st April 1946 and 31st March 1950 (both days inclusive). at 15 per cent. of the cost thereof to the assessee ;

(b) In the case of buildings, the erection of which was begun after 31st March 1945 and completed before 1st April 1946, at 10 per cent. of the cost thereof to the assessee ;

(c) In the case of buildings, the erection of which is to begin after 31st March 1950 at 10 per cent. of the cost thereof to the assessee ;

(d) In the case of new machinery or plant installed after 31st Mar h 1945, at 20 per cent. of the cost thereof to the assessee.

This initial depreciation allowance is granted in addition to the usual depreciation allowance ; but it will *not* be taken into account in arriving at the written-down value of an asset.

This initial depreciation is granted only in respect of *new* buildings erected and *new* machinery or plant installed after the 31st March 1945. This relief has been granted in order to assist industrial concerns to start their work of reconstruction and to modernise and to re-equip their worn out plant.

Conditions for the grant of depreciation allowance. To obtain depreciation allowance the following two conditions must be fulfilled ; (i) The required particulars regarding depreciation (as given in Part V of the form of return of income) must be furnished to the Income-Tax Officer ; and (ii) The aggregate amount of the depreciation allowance should not exceed the actual cost of the asset to the assessee. It should, however, be noted that under the present system where depreciation is calculated on the written-down value of an asset, the total depreciation allowed can never exceed the cost of the asset.

Prescribed Rates of Depreciation. These are given in Appendix A.

Written-down Value. The written-down value of an asset means (a) in the case of an asset acquired in the previous year, the actual cost to the assessee ; and (b) in the case of an asset acquired before the previous year the actual cost to the assessee *less* all depreciation actually allowed to him *except* any initial depreciation. It means that the term written-down value does not include any unabsorbed depreciation.

But the first proviso to section 10 (5), which has been inserted by the Income-Tax Amendment Act of 1946, has introduced a qualification to the above method of calculation of the written-down value. This proviso states that in respect of a building previously owned by an assessee and brought into use for the purpose of his business after 28th February 1946, the written-down value shall mean the actual cost to the assessee *minus* such depreciation as would have been allowable, had the building been used all along for the purpose of the business. The rate of depreciation chargeable for this intervening period will be the rate in force on the date of the introduction of the building into the business. This proviso will apply even in respect of an ancient building acquired at the time when under the law then in force depreciation allowance was not thought of,

The actual cost in the case of acquisition by purchase would be the price paid for the building, machinery, plant or furniture *plus* any other incidental capital expenditure such as cost of transport, import duties, cost of erection, etc. But in the case of a transferee of a business, who purchases the buildings, machinery, plant or furniture at a valuation from his predecessor in interest, the actual cost is fixed at the cost at which he purchases and not the cost to the original owners. In cases where the acquisition is made not by purchase but by a bequest or a gift, the actual cost to the legatee or donee would be *nil*, and hence there is no scope for giving any depreciation or obsolescence allowance to him at all.

Succession to Business. When a person succeeds to a business, the depreciation allowance due to him in respect of buildings, machinery, etc., taken over by him from his predecessor should be worked out on the basis of actual cost to the purchaser and not on the cost to the predecessor.

But where, owing to a change in the proprietorship of a business, the successor is taxed in respect of the profits received by his predecessor under the proviso to section 26 (2), the actual cost to the assessee shall be the actual cost to the person succeeded. That is to say, in the case of the first assessment on a successor the predecessor's right is carried over intact.

Unabsorbed Depreciation. When, on account of the absence or insufficiency of profits of any business of the assessee, the full or a part of the depreciation allowance cannot be claimed, the balance of the depreciation allowance not so claimed is known as unabsorbed depreciation. But the amount of depreciation which is disallowed for any other reason (e. g., the required particulars not furnished to the Income-Tax Officer) is not included in the term unabsorbed depreciation.

If an assessee, in addition to his business income, has any other source of income such as salary, income from property, etc., then the amount of unabsorbed depreciation can also be set off against such other income ; and only the amount of depreciation not so set off will be the amount of unabsorbed depreciation to be carried forward.

The proviso to section 10 (2) (vi) regulates unabsorbed depreciation as follows :—

(a) Unabsorbed depreciation on account of assessment years prior to 1939-40 cannot be carried forward but should be capitalised, i. e., added to the depreciated value of the asset for the purpose of arriving at its written down value for 1940-41 assessment ;

(b) Unabsorbed depreciation on account of assessment years 1939-40 onwards can be carried forward *indifinitely* to be claimed in future assessments subject to the condition that, if there is a business loss also carried forward, such business loss will be set off first before allowing the unabsorbed depreciation. This provision is obviously in favour of the assessee, because business losses can be carried forward for future set-off only for six years, whereas the unabsorbed depreciation allowance can be carried forward indefinitely.

When a business is closed in any year, the carry-forward of its unabsorbed depreciation will not be allowed, and the unabsorbed depreciation allowance like any other loss will have to be regarded as a capital loss.

Computation of Depreciation Allowance. Unlike obsolescence allowance it is not necessary for the depreciation allowance that it should be actually written off in the books of the assessee.

The written-down value system, which was adopted for the first time in the assessment year 1940-41, renders it unnecessary to work out separately the

allowance on each addition made to asset, since the allowance at the fixed percentage is due on whole written-down value of the asset in each class regardless of the date of purchase. For the calculation of depreciation all that is necessary is this ;

(a) Group the assets according to the rate of depreciation allowed, e. g., all assets entitled to 6% depreciation put together, and so on ;

(b) From the written-down value of the asset brought forward from the previous financial year, deduct the previous assessment's depreciation allowance ;

(c) Add the cost of additions and deduct the sales of assets, if any, made during the previous year ;

(d) The written-down value of the asset for the current assessment having thus been ascertained, work out the depreciation allowance at the prescribed rate.

For the next assessment year, the process will be repeated.

Extra Shift Allowance. In the case of machinery and plant, an extra depreciation allowance up to a maximum of 50 per cent. of the normal depreciation allowance is allowed where an assessee claims such allowance on account of double or multiple shift working and satisfies the Income-Tax officer that the asset has actually worked double or multiple shifts. This is known as extra shift allowance and is proportionate to the number of days during which double or multiple shifts are worked.

For the purpose of granting this extra allowance the normal number of working days throughout the year will be taken as 300. For example, if a factory has worked double or multiple shifts for 100 days, the extra depreciation allowance will be one-third of fifty per cent. of the normal depreciation allowance for the whole year in respect of machinery and plant.

Illustration

1. If a business, whose accounting year ends on 30th June, purchased machinery for Rs. 50,000 in October 1945, then for the 1947-48 assessment year the written-down value will be Rs. 50,000 and the depreciation allowance (at 7%) would be Rs. 3,500.

A factory building (second class) was acquired for Rs. 50,000 in June 1945 by a firm whose books are closed at the end of the calendar year. Therefore its written-down value (at 5% depreciation) would be Rs. 50,000 for the assessment year 1946-47 ; Rs. 57,500 for the assessment year 1947-48 ; and Rs. 45,125 for the assessment year 1948-49.

3. A firm which closes its books on 31st March acquired in July 1938 an asset costing Rs. 20,000, the prescribed rate of depreciation on this asset being 9% on the written-down value. The depreciation allowance for the assessment year 1946-47 was unabsorbed to the extent of Rs. 1,000 and the amount of depreciation actually claimed up to and including the assessment year 1946-47 amounted to Rs. 4,000.

The written-down value of this asset for the 1947-48 assessment year will be (Rs. 20,000 – Rs. 4,000) or Rs. 16,000, and the depreciation allowance for 1947-48 assessment would be :—

At 9% on Rs. 16,000	...	Rs. 1,440
plus the unabsorbed depreciation brought forward		1,000
		2,440

Assuming that the full amount of Rs. 2,440 is claimed in the 1947-48 assessment then for the next assessment year (1948-49) the written down value of this asset will be Rs. 13,560.

4. A cotton mill company, whose accounting year ends on 31st March, purchased certain machinery in 1942 for Rs. 1,20,000 and the depreciation allowance actually claimed for this asset up to and including the 1941-42 assessment year amounted to Rs. 31,500.

Work out the admissible depreciation allowance in respect of this asset for the assessment years 1942-43 and 1943-44, if the rate of depreciation prescribed is 10% on the written-down value, if this asset was used double shift for 100 days in the previous year 1941-42 and for 200 days in the previous year 1942-43, and if the full depreciation allowance was claimed in the 1942-43 assessment. *(Agra B. Com. 1943)*

		Rs.
Actual cost of machinery	...	1,20,000
Less Depreciation actually allowed	...	31,500
Written-down value for 1942-43 assessment	...	88,500
Normal depreciation at 10%	...	8,850
Extra shift allowance, being one-third of fifty per cent. of the normal	...	1,475
Depreciation for 1942-43 assessment	...	10,325
Actual cost of machinery	...	1,20,000
Less Depreciation actually allowed	...	41,825
Written-down value for 1943-44 assessment	...	78,175
Normal Depreciation at 10%	...	7,817
Extra shift allowance, being two-thirds of fifty per cent. of the normal	...	2,605
Depreciation for 1943-44 assessment	...	10,422

5. A person set up a new business on 1st August 1945. For this purpose he purchased machinery for Rs. 20,000 from another person who was closing down his business and installed it in his own shop which was constructed at a cost of Rs. 10,000 in 1920.

If in his first assessment for 1946-47 the assessee claims initial depreciation, provided by the Income-Tax Amendment Act of 1946, on the building and the machinery and normal depreciation for 8 months on the cost thereof, on what basis would you allow the claims and on what value? *(Income-Tax Departmental Exam. 1946).*

As both the shop building and machinery are old, he is not entitled to any initial depreciation in respect of them, because initial depreciation is allowed only in the case of new buildings and new machinery.

In his first assessment for the year 1946-47 he is, however, entitled to the full year's normal depreciation at the prescribed rates on Rs. 10,000 and Rs. 20,000 in respect of building and machinery, which figures are their written-down values.

As the shop building has been brought into use before the 28th February 1946, the first proviso to section 10 (5) which has been explained earlier in this chapter, will not apply.

Obsolescence Allowance. Under section 10 (2) (vii), where building, machinery or plant used for business purpose is sold or discarded or demolished or destroyed, the excess of its written-down value over the sale price or its scrap value (as the case may be) is allowed as an obsolescence loss subject to the following conditions :—

(a) That the amount of the obsolescence loss is actually written off in the books of the assessee.

(b) That where the sale proceeds of an asset exceed the written down value; the excess will be taxed to the extent of the entire depreciation allowed, by any excess over the cost of the asset will be capital profit chargeable under section 12 A.

For example, if the written.down value of machinery, which cost Rs. 1,00,000 is Rs. 40,000, and if it is sold the position will be as follows :—

1. If it is sold for Rs. 30,000 the obsolescence allowance is Rs. 10,000.

2. If it is sold for Rs. 40,000, there is no obsolescence allowance and no taxable profit.

3. If it is sold for Rs. 70,000, there is no obsolescence allowance. but there is a taxable profit of Rs. 30,000.

4. If it is sold for Rs. 1,00,000, there is no obsolescence allowance, but there is a taxable profit of Rs. 60,000.

5. If it is sold for Rs. 1,20,000, there is no obsolescence allowance, but there is a taxable business profit of Rs. 60,000 and a taxable capital profit of Rs. 20,000.

(c) That where an asset is discarded, demolished or destroyed, and any insurance; salvage or compensation moneys are received, these moneys, if they are less than the written-down value minus the scrap value, will be deducted from the obsolescence allowance admissible, and, if they are greater, the excess will be taxed to the extent of the entire depreciation allowed minus the scrap value.

For example, the written-down value of machinery, which cost Rs. 1,00,000, is Rs, 40,000. If it is insured and if it is destroyed leaving a scrap value of Rs. 10,000, the position will be as follows :—

1. If the insurance money received is Rs, 20,000, the obsolescence allowance is Rs. 10,000.

2. If the insurance money received is Rs. 30,000, there is no obsolescence allowance and no taxable profit.

3. If the insurance money received is Rs. 60,000, there is no obsolescence allowance, but there is a taxable profit of Rs. 30.000.

4. If the insurance money received is Rs. 90,000, there is no obsolescence allowance, but there is a taxable profit of Rs. 60,000.

5. If the insurance money received is Rs. 1,10,000, there is no obsolescence allowance, but there is a taxable business profit of Rs. 60,000 and a taxable capital profit of Rs. 20,000.

(d) That where a building previously owned by an assessee is brought into use for the purposes of his business after the 28th February 1946, its

written-down value for computing the amount of obsolescence loss will be the actual cost *minus* all depreciation that would have been allowable had the building been used all along by the assessee in his business since date of its acquisition. The rate of depreciation chargeable for this intervening period will be the rate in force on the date of the introduction of the building into the business.

N. B.—If a claim is made for obsolescence allowance on the ground of discard, it should be made in the year in which the asset is actually discarded. But this will not prevent an allowance being claimed for obsolescence loss on a later actual sale of the discarded asset.

Where any building, plant or machinery is not used wholly for purposes of business, only the proportionate amount of obsolescence allowance can be claimed.

Test Questions

1. What do you understand by the term 'Depreciation'? How is it allowed? Who is entitled to it, when, and to what extent?

Explain how the unabsorbed depreciation of one year can be allowed subsequently. Does the carry-forward of depreciation in any way differ from the carry-forward of losses? Explain the provisions fully.

(Agra M. Com. 1947).

2. Write a short essay on "Depreciation and Taxable Income from Business."

3. Explain and illustrate the meaning of the term 'Written-down value.'

4. What is obsolescence loss? Is it allowed as a deduction for income-tax purposes?

5. Define the following terms: Plant; Original Cost; Unabsorbed Depreciation.

6. What is extra shift allowance and how is it computed?

7. A owns a ginning factory which he is not running himself but has leased out to B. A claim for depreciation is made in respect of the factory both by A and B. How would you deal with the depreciation claim.

(Agra M. Com. 1947).

CHAPTER 11

METHOD OF ACCOUNTING

The provisions of section 10 and 12 have been so worded as to make it clear that as regards income from business and other sources no uniform method of accounting is prescribed for all tax-payers, and that every assessee may, so far as possible, adopt such form and system of accounting as is best suited for his purposes. The only restrictions imposed by section 13 are—

1. That the method of accounting adopted must be one that clearly reflects the income of the assessee in respect of the previous year ; and
2. It is the one regularly employed by him for the purposes of his business.

If the tax-payer does not regularly employ a method of accounting which clearly reflects his income for the previous year, the computation will be made in such manner as in the opinion of the I. T. O. does clearly reflect it. Therefore if the accounts kept by an assessee are such that the profits cannot easily be ascertained from them, the assessment is made on an assumed flat rate of profit on the turnover and the basis of the flat rates is the previous practice and experience of the Income-Tax Department. There is nothing to prevent an I. T. O. from charging two different flat rates for two different assessees in the same locality.

But section 13 does not justify a bald estimate of income by the I. T. O. without any reasons for arriving at the figure. He is not entitled to make a guess without any evidence. He must be consistent and logical and must not act arbitrarily even if he has only to make an estimate. In no case may an I. T. O. reject genuine accounts merely on the ground that they are complicated.

It is, however, the duty of an assessee to present accounts showing his true income ; and if he fails to do so and if the I. T. O. makes the estimate to the best of his ability on the materials before him the assessee must pulup with it.

Change in accounting system :—When an assessee desires to change his accounting system and makes such a request, the I. T. O. in considering it should, if he is prepared to allow the change, take steps to secure that no profits escape taxation on account of the change. Whether a method of accounting has been regularly employed is a question of fact, but it is open to the assessee to change his method though not from year to year. In doing so he should satisfy the income-tax authorities that he is doing so in good faith and not with a view to defrauding revenue.

While section 13 leaves it to the discretion of the I. T. O. decide whether a particular system of accounting should be accepted or whether a change in the system of accounting should be allowed, the discretion of the I. T. O. in this matter can be questioned in the course of an appeal against the assessment.

System of accounting :— There are three systems of keeping accounts.

1. The cash basis system—Where a record is kept of actual receipts and actual payments, entries being made only when money is actually collected or disbursed. This system is quite inadequate for the needs of a trading

concern where there may be a number of credit transactions. The income of a business cannot be computed correctly under this system. It is therefore unusual for a trader to calculate his profits on this system.

This system can be very well adopted in a profession such as that of a doctor, accountant or lawyer where nearly all transactions are for cash, and also by non-trading concerns, such as a club, orphanage, school, college, etc., whose aim of keeping accounts is to secure that all income that should be received has been received and that the actual income received has been properly accounted for.

If, however, a trader adopts this system of book-keeping and wishes to calculate his profit therefrom, the difference between the value of his opening and closing stocks must be taken into account in doing so, so that a proper and even distribution of his profits over a series of years may be secured.

2. The mercantile accountancy system :—This is also known as book profits system of accountancy. Under this system a record is kept of all transactions both cash and credit and a profit and loss account is prepared in respect of all the income and expenditure of the year whether actually received and paid in cash or not. Under this system entries are made in the accounts on the date of the transactions irrespective of the date of payment. This is the system by which the true business profits can be ascertained.

3. Hybrid systems of accounting :—Besides the cash basis and mercantile system, there may be several hybrid or mixed systems of book-keeping, that is to say, a trader may record one set of transactions on the cash basis and for another set he may follow the mercantile method, e. g., purchases and sales of goods may be recorded on the mercantile basis and income and expenses on the cash basis. *An assessee can adopt hybrid system of bookkeeping so long as he regularly employs it.*

Note :—It is the method of accounting adopted by an assessee that determines the period within which any item of gross revenue or any deduction therefrom is to be accounted for and which determines whether particular allwances are or are not permissible. It is for this reason, that the Act does not contain a complete statement of the deductions that are permissible or not permissible in working out business profits, professional earnings or income from other sources, since certain allowances can occur only where the mercantile accountancy system is adopted. There can, for example, be no bad debts where the cash system of book-keeping has been followed.

Where a complete system of mercantile accountancy has been adopted, the assessee has to attach a copy of his Profit and Loss Account and Balance Sheet to his Return of Total Income to be filed with the I. T. O.

Where the book-keeping records are incomplete or where there is no bookkeeping at all, the assessee may ascertain his gross profit from his sales, and then estimate his taxable income by deducting the admissible expenses from the gross profits. All this information must be given in his Return of Total Income to be filed with the I. T. O.

Test Questions

1. Write an essay on "The Method of Accounting for Income-Tax Purposes."

2. Name and briefly describe the principal systems of accounting that may be adopted by assessees.

CHAPTER 12

SET-OFF AND CARRY—FORWARD OF LOSSES

Set-off of losses :

Under section 24 (1) a loss (not being a capital loss) sustained by an assessee under any head of income can be set off against his income under another head *in the same year of assessment*, subject to the following provisions :—

1. Where the assessee is an unregistered firm, that firm and that firm alone can set off the losses incurred by the firm, and no member of an unregistered firm is allowed to set-off his share of the firm's loss against his own income.

2. Where the assessee is a registered firm the loss of the registered firm is to be set-off against the registered firm's own income in the first instance and then the balance of the loss allocated between the partners and set-off against the partner's own income.

3. Where an unregistered firm has been dealt with as a registered firm under section 23 (5) *(b)*, losses can be set off like a registered firm.

Carry-forward of business losses for set-off against subsequent assessments :

Section 24 (2) allows the carrying forward of business losses. A loss due to depreciation can be carried forward for an indefinite number of years, the unabsorbed depreciation not being treated as a loss at all. Other business losses (if they cannot be wholly set-off against other income for the same year) can also be carried forward and set-off against the profits of the assessee *from the same business* for the following year. It must be emphasised that business losses cannot be carried forward and set-off only against income from any other business or from any other source. They can be carried forward and set-off only against income from the same business, and if that business has been discontinued, the right to carry forward the loss lapses.

If, owing to the inadequacy of profits, the loss cannot be wholly exhausted in the year following the year of assessment, it can be carried forward and set off against the profits of the next year and so on up to a limit of *six* years.

Where unabsorbed depreciation is also in existence, the business loss carried-forward should be set off in priority to the setting-off of such unabsorbed depreciation.

With regard to losses by unregistered and registered firms, the same provisions operate for the carry-forward and set-off under section 24 (2) as for the set-off of losses under section 24 (1).

Note.—With regard to the set-off and carry-forward of Indian States losses and losses under the head "Capital Gains" refer to Chapter 4 and Chapter 8 respectively.

Change in constitution or succession. In accordance with the principle that the liability or benefit should attach to the person receiving the profits or incurring the loss, it is provided that where a change has occurred in the constitution of a firm or where there has been a succession to a business (otherwise than by inheritance), only the person actually incurring the loss is entitled to set it off against his income.

Thus, when a change has occurred in the constitution of a firm, the firm shall not be entitled to carry forward and set-off the share of loss of a retired

or deceased partner, nor shall any partner be entitled to the benefit of any portion of the said loss which is not apportionable to him.

Illustrations

1. If a registered firm consisting of A, B and C is reconstituted, A retiring and D coming into the partnership, A by leaving the firm forfeits the right to carry forward his share of the loss made by the old firm, although A's right to set off this loss against his other income for the same year remains unaffected. Again B, C and D do not inherit this loss and cannot claim to set-off against their shares of the future profits the share of loss incurred by A, Of course, B can carry forward his own share of loss made by the old firm and C can also carry forward his share.

2. If *A*, *B* and *C* are equal partners in an unregistered firm which has made a loss of Rs. 15,000 and if *A* dies or retires, the firm of *B* and *C* as reconstituted can carry forward only Rs. 10,000 and not Rs. 15,000 because Rs. 5,000 is the loss of *A*, a deceased or retired partner.

3. If *X* is succeeded in a business by *Y*, and *X* has incurred a loss, he forfeits the right to carry forward by transferring the business to *Y*, who, however, cannot claim to set-off against this profits the loss incurred by *X*.

Determination of loss. The determination of a loss is now important for the setting off against future profits, and therefore, it is provided that the I. T. O. shall pass an order determining the loss and this order is appealable in the same way as an order determining an assessment upon which tax is payable.

Test Questions

1. Explain fully the provisions of the Income-Tax Act regarding the set-off of losses in computing the aggregate income of an assessee, and point out clearly the differences in (a) losses of the same year, (b) losses of the earlier years, (c) losses of a registered firm, and (d) losses of an unregistered firm. *(Agra M. Com. 1946).*

2. Explain the difference between the set-off of losses and the carry-forward of business losses.

3. How is the set-off and carry-forward of losses affected when there is a change in the constitution of a business or when a business changes hands ?

CHAPTER 13.

TOTAL INCOME AND TOTAL WORLD INCOME

The method of computing the taxable income (or deductible loss) from the various sources, i. e., salaries, interest on securities, income from property, profits of business, income from other sources, and capital gains has been explained in detail in three preceding chapters; and the method of computing the total income and the total world income of an assessee will be discussed in this chapter. As the total income and the total world income of assessees are the bases of their assessment, the correct computation of these two things is an important matter.

Total Income. The total income of an assessee means the total amount of income (including taxable capital gains), for which he is chargeable on the basis of his residence, and which are derived from taxable sources. That is to say, the total income of a person is computed with regard to his residence.

This meaning of the term total income is, however, varied in the following two cases:—

1. Under the second proviso to section 55, for the purpose of calculating the amount of super-tax payable by a partner of an unregistered firm or a member of an association of persons where such a firm or association itself has been assessed to super-tax;
2. Under the proviso to section 58E, for the purpose of calculating the exempted amount of life insurance premium and provident fund contributions of a member of a recognised provident fund.

Total World Income. This includes all income wherever arising *except* income which is not taxable. The computation of the total world income is required only in the case of non-residents, whose rate of tax on total income is determined by reference to their total world income. In computing the total world income, the statutory deduction of Rs. 4,500 from the unremitted foreign income should not be made, because that allowance is available only to residents.

Other provisions applicable to total income. It has already been stated in Chapter 3 that under section 4 (3) certain kinds of income are totally exempt from taxation and are not included in the total income of the person receiving them. Section 16, 44D, 44E and 44F, which require that in computing the total income of an assessee certain incomes should be included, make the following provisions in regard to the computation of total income:—

1. **Exempted Income.** All income which is exempt from both income-tax and super-tax and also all income which is exempt from income-tax but not from super-tax (as detailed in Parts II and III of Chapter 3) should be included in the total income.

2. **Earned Income Allowance.** The amount of earned income allowance to which an assessee is entitled should be included in his total income.

3. **Share of a Firm's Income.** When the assessee is a partner of a firm, his share of the firm's profit or loss should be taken, for the purpose of computing his total income, to be salary, interest, commission or other remuneration payable to him by the firm in respect of the previous year increased or decreased respectively by his share in the balance of the profit or loss of the firm,

4. **Transfer of Income.** If a person makes a settlement of income upon other persons (whether such settlement is revocable or not), the assets whose income is so settled remaining the property of the settler, then such income is deemed to be the income of the settler or transferor and should be included in his total income.

5. **Revocable Transfer of Assets.** If a person makes a revocable transfer of assets to other persons, than the income of such assets is deemed to be the income of the settler and should be included in his total income *except* in the following two cases :—

(a) Where such a settlement is not revocable for a period exceeding six years and the settler derives no benefit, direct or indirect, from the income ; and

(b) Where such a settlement is not revocable during the lifetime of the transferee (or the beneficiary) and the settler derives no benefit direct or indirect, from the income.

But it must be noted that when the period of non-revocability expires, the settler will be automatically assessed on the income, unless he makes a new settlement which is non-revocable for another period exceeding six years.

Benami Transactions. The word 'benami' means without name. A benami transaction is one which is made not in the name of the real person but in the name of someone else. Thus, a person in order to evade tax may transfer his property nominally in favour of a third party, or a person in acquiring some property may not purchase it in his own name but may purchase it benami in the name of a third person.

For the purposes of assessment, the income-tax authorities are entitled to go into the question of the ownership of property and to make the assessment on the real owner.

6. **Dividends.** A dividend received by a shareholder is deemed to be his income for the previous year in which it is paid or deemed to be paid, and for the purpose of computing his total income the actual amount of dividend received should be grossed up as explained in Chapter 7.

7. **Income of Wife.** So much of the income of an assessee's wife as arises directly or indirectly from the following sources should be included in his total income :—

(a) From her membership in a firm of which the assessee is a partner ; or

(b) From assets transferred directly or indirectly to her by the assessee otherwise than for adequate consideration or in connection with an agreement to live apart.

3. **Income of Minor Child** So much of the income of an assessee's minor child as arises directly or indirectly from the following sources should be included in his total income —

(a) From his or her admission to the benefits of partnership in a firm of which the assessee is a partner ; or

(b) From assets transferred directly or indirectly to the minor child (not being a married daughter) by the assessee otherwise than for adequate consideration.

9. **Transfer of Asset to Third Parties.** If a person makes a transfer of assets, otherwise than for adequate consideration, to another person or an association of persons for the benefit of his (transferor's) wife or minor child or both, then the income from such assets is deemed to be the income of the transferor and should be included in his total income.

10. **Transfer of Assets Abroad.** Section 44-D provides that if a person transfers assets to a non-resident or to a person not ordinarily resident in British India for the purpose of avoiding tax, the Income-Tax Officer may treat the income from such assets as the income of the transferor.

The principal kind of device which this provision is designed to prevent is the flotation of dummy company abroad to take over the assets of a wealthy super-tax payer in British India. Thus a man with a large income which is liable to super-tax transfers his assets to a private company of which he is substantially the only shareholder and which is registered abroad. This company, being registered abroad, cannot be caught under section 23-A which deals with non-distribution of profits. The transferor himself does not receive income or dividends from the company, but he receives loans. He is never asked to repay those loans because virtually he is the company. So he receives in the form of loans precisely the same money which he would previously have received in the form of income, and, therefore, he avoids all tax which is payable on the income.

The wording of this section is wide enough to cover all possible forms of this device however the legal documents may be worded, but it leaves all genuine commercial transactions outside the net. The general principle of the section is to treat all income which has been alienated by the resident person as his income whether it is called loans or repayments of loans.

11. **Bond Washing.** Section 44-E deals with avoidence of tax in respect of securities. The interest or dividend on securities fall due on definite dates, and the holder of the security or the share on th se dates is the person chargeable to tax. But if he transfers it just before the due date of the interest or the date of the declaration of the dividend, he would become free from the tax liability. The extra sale price which he might have received by selling the security cum-dividend would be merely a capital-profit in his hands and may not be taxable. Now if the transferee should at the same time, by reason of his having little or no income otherwise, be exempt from tax in respect of the interest or the dividend, then the tax is wholly or partly avoided. After the due date of the interest, or after the declaration of the dividend, the transferor can get his security back by a retransfer and put himself in his original position with impunity.

This section provides that where the transfer is made with an agreement to buy back, the transferor shall be regarded as the owner despite the transfer and shall be chargeable in respect of the interest or the dividend. Such transactions are known as *bond washing* transactions.

The transferee chosen may be a person carrying on a business of dealing in securities such as a bank, an investment trust or a stock broker, in whose hands the profit or loss on the purchase and sale of securities is revenue and therefore taxable. The purchase price paid by the transferee would necessarily be greater than the sale price, because the former would be cum-dividend whereas the latter would be ex-dividend and therefore the transaction would always show a loss. The dealer in securities would be entitled to deduct this loss as a business loss, but, of course, it would be offset by the interest or dividend received, the net result, however, being that there is no payment of tax. Therefore, under section 44-E, if a business man dealing in securities buys with an agreement to sell back, the transaction would be completely disregarded in his assessment, and the original owner of the securities would be held liable to tax in respect of the interest or the dividend despite the transfer.

Very heavy penalties are imposed for failure to comply with the Income-Tax Officer's demand for information on these matters. The penalty can be as much as Rs. 500 per day so long as the default continues.

How to Compute Total Income and Total World Income

The total income and the total world income of an assessee is computed as follows :—

1. To ascertain the total income of an assessee, first compute the taxable income (or deductible loss) of the previous year under each head of income including capital gains in the manner described in Chapter 6, 7 and 8, and then add together the various taxable incomes thus ascertained, deducting therefrom the loss (if any) under any head for the same previous year. Further, any business loss carried forward from the earlier previous years—which satisfy the conditions of section 24 (2) and (2B) – may also be deducted from the previous year's profit of the same business or from the previous year's capital gains. The resulting figure from this calculation would then be the total income of the previous year.

In-doing so the income and loss arising both in British India and without British India should be taken into account subject, of course, to the deduction of Rs. 4,500 from the unremitted foreign income – calculating income arising in British India under one heading and that arising without British India under another. The latter income may also be further classified into (i) that which is assessed on the remittance basis and (ii) that which is assessed on the accrual basis.

2. To find out the total world income of a non-resident, first ascertain the income arising in British India, which is his total income ; then to this total income add all his foreign income derived from taxable sources, the result would be his total world income.

Illustrations

1. Assume the following particulars regarding the taxable income or deductible loss of a person for the previous year ended 31st March 1947, and then calculate his total income and exempted income (a) when he is a resident ordinarily resident, (b) when he is a resident not ordinarily resident, and (c) when he is a non-resident. In the last case ascertain his total world income also.

Income arising in British India :

1. Salary Rs. 725 and dearness allowance Rs. 100 per month and bonus Rs. 1,600.
2. Interest on tax-free securities Rs. 500 and on other securities (gross) Rs. 1,000.
3. A loss of Rs. 1,000 has been computed from property.
4. Share of profits in a registered firm Rs. 10,000 and in an unregistered firm Rs. 5,000.
5. Dividends (gross) Rs. 600 and interest on fixed deposits Rs. 400.
6. Total capital gains Rs. 20,000.

Income arising without British India :

1. Amount of foreign income actually remitted to British India from Africa Rs. 10,000.
2. Unremitted foreign income from business in Iran (controlled from India) Rs. 11,000 ; from property in Iran Rs. 2,000 : from business in Jaipur State Rs. 12,000.
3. A loss of Rs. 1,000 on account of the Iranian business has also been carried forward from the 1946–47 assessment year.

He paid Rs. 8,000 as premia on his life policies for Rs. 1,00,000.

Statement of Total Income

		(a) Ordinary Resident Rs.	(b) Resident Rs.	(c) Non-resident Rs.
British Indian Income :				
1. Salary	8,700			
D. A.	1,200			
Bonus	1,600 ...	11,500	11,500	11,500
2. Interest on Securities :				
Taxed	...	1,000	1,000	1,000
Tax-free	...	500	500	500
3. Property (Loss)	...	-1,000	-1,000	-1,000
4. Business :				
Profits from registered firm		10,000	10,000	10,000
Profits from unregistered firm		5,000	5,000	5,000
5. Other Sources :				
Dividends (gross)	...	600	600	600
F. D. Interest	...	400	400	400
6. Capital Gains	...	20,000	20,000	20,000
Total of Indian income		48,000	48,000	48,000
Foreign Income :				
1. Actually remitted	...	10,000	10,000	—
2. Unremitted[1]	...	7,500	5,500	—
3. Unremitted Indian State income		12,000	—	—
Total Income	...	77,500	63,500	48,000
Add all foreign income	...	...	...	34,000
Total World Income		—	—	82,000

[1]This is ascertained as follows :—

	Ordinary resident Rs.	Rs.	Resident Rs.	Rs.
Business (11,000-1,000 set off)	10,000		10,000	
Property income	2,000			
	12,000			
Less Statutory Allowance	4,500	7,500	4,500	5,500

Statement of Exempted Income.

	(a) Ordinary resident Rs.	(b) Resident Rs.	(c) Non-resident Rs.
1. Tax-free Interest ...	500	500	500
2. Life Insurance Premia ...	6,000	6,000	6,000*
3. Profits from unregistered firm	5,000	5,000	5,000
4. Accrued income in Indian State	12,000	—	—
5. Profits from registered firm taxed in the hands of the firm	—	—	10,000
	23,500	11,500	21,500

*The life insurance premium paid is exempt only when it is paid out of an assessee's taxable income. It is assumed here that it was so paid.

For information relating to registered and unregistered firms, refer to Chapter 17.

2. A, an ordinary resident, makes a return of his income for the year ended 31st March 1947 as follows :—

	Rs.	Rs.
Salary		24,000
Dividend from a tea company, assessed on 40% of its profits, declared in December 1946 (Certificate under section 20 produced)		6,000
Loss from speculation business discontinued In January 1946 determined in his assessment for 1946-47 as under :		
Speculation loss	40,000	
Less Salary and property incomes of the year ended 31-3-46 set off	36,000	4,000
Total Income		30,000

Insurance premiums (Receipts produced) Rs. 3,000

On enquiry the assessee supplied the following information :—

(a) Monthly salary Rs. 3,000. The assessee was on leave for four months ex-India, and out of four months' leave salary at the rate of Rs. 3,000 per month two months' leave salary was drawn ex-India, the balance being drawn in British India on return from leave during the following year.

(b) The dividend income of Rs. 6,000 represents the amount declared by the c mpa ıy in favour of the assessee, but 60% of the company's income was derived from agriculture.

(c) One-fourth of the assessee's house property is reserved for his own occupation. The correct rental value of the other part of the house is Rs. 4,800, but the assessee's agent charges one-sixth of the rent as his commission.

(d) The particulars of his insurance policies are :—(i) Endowment policy on the life of his wife, capital sum assured Rs. 10,000 premium Rs. 2,000 ; (ii) Whole-life policy on his own life, capital sum assured Rs. 10,000, premium Rs. 500 ; (iii) Marriage Endowment policy for daughter for Rs. 5,000 payable on the happening of the marriage, but not otherwise, premium Rs. 500.

Determine the total income of the assessee and his exempted income for the assessment year 1947-48. *(Income-tax Departmental Exam. 1944).*

Total Income for the assessment year 1947-48

			Rs.
1. Salary ...		...	36,000
2. Property :			
Letting value of portion let		4,800	
Less one-sixth for repairs	800		
Collection charges 6%	288	1,088	
		3,712	
Annual value of residence	1,600		
Less one-sixth for repairs	266	1,334	5,046
3. Dividends gross at 60 pies per rupee			6,857
Total Income			47,903

The exempted income will be Rs. 2,000 on account of life premiums.

Test Questions

1. Under what circumstances can the income of the wife or a minor child of an assessee be included in his total income ? Who will be entitled to earned income relief in such cases and to what extent ? *(Agra M Com. 1947)*

2. An assessee creates a trust by which the income from assets which remain his property is payable to his sister for a period of seven years. It is claimed that the case falls within the third proviso to section 16 (1) (c) and the income is not therefore liable to be included in his total income. Is this correct ?

3. Y has made a settlement by virtue of which the income from interest on securities, which remain his property, is paid to his wife for her life time. The settlement is not in connection with an agreement to live apart. How will you deal with the matter ?

4. What is the difference between total income and total world income ?

5. What is a benami transaction ? X makes an investment of his own money in the name of his major son. The yield of the investment is spent by the son to defray expenses of his education. Is this a benami transaction ? In whose hands would you assess the investment income ?

6. Explain the term 'Bond-washing.' How is it prevented by law ?

CHAPTER 14

DEDUCTION OF TAX AT SOURCE

Section 18 provides for the deduction of tax at source in respect of salaries, interest on securities, other interest and other sums chargeable to tax paid to non-residents, and dividends.

1. Salaries

1. The person responsible for paying any income chargeable under the head salaries must, at the time of payment, deduct *(a)* in the case of an employee who is resident in British India, income-tax and super-tax at a rate representing the average of the rates applicable to his estimated total income under the head salaries ; and *(b)* in the case of an employee who is not resident in British India, income-tax at the maximum rate and super-tax at the rate or rates applicable to his estimated income under the head salaries. In doing so, the earned income allowance must be taken into account.

However, if the non-resident employee obtains a certificate from the I. T. O. that his total income or the total world income is below the chargeable minimum or is only liable to a lesser rate, the deduction of tax (both income-tax and super-tax, either shall not be made or shall be made at the lower rate.

NOTE. When calculating the amount of monthly tax deduction from the salary of an employee, rebate of income-tax (but not super-tax) at the average rate of income-tax applicable to the total income of the employee from salary is admissible in respect of the following deductions, contributions and premiums, ***subject to the conditions explained in a previous chapter.***

(a) Sums deducted from a government servant's salary for securing a deferred annuity to him or for making provision for his wife or children ;

(b) Employee's contributions to a provident fund to which the Provident Funds Act of 1925 applies or to a recognised provident fund or to an approved superannuation fund : and

(c) Premiums paid by the employee for life insurance ***if the employer is satisfied about the amount of such premiums.***

2. Where salary is payable out of British India, by or on behalf of Government, tax must be deducted therefrom in India and such salary is to be converted into rupees at the prescribed rate of 1/6 to the rupee.

3. The employer can increase or reduce the amount of tax to be deducted in order to adjust any excess or deficiency arising out of any previous deduction or failure to deduct.

4. When deduction of tax is made by employers other than Government, they are required to foward to the I. T. O. statement containing the prescribed particulars.

NOTE. In calculating the amount of tax payable, the fraction of a rupee of income is neglected, and the amount of tax to be deducted monthly is worked out to the nearest anna.

How to work out the amount of monthly tax deduction. In the examples given below, the method of calculating the amount of income-tax and super-tax

to be deducted monthly from the salary of an employee is illustrated, it being assumed that the employee is a resident, and that the previous year is the year ended on 31st March 1947 :—

(a) Salary at the beginning of the year Rs. 600 p. m. the increment of Rs. 30 being due after one month, and the employee contributing one anna per rupee to a recognised provident fund.

The total estimated annual income from salary is Rs, 7,500. The earned income allowance is Rs. 1,500 ; the amount of income-tax chargeable on Rs. 6,000 is Rs. 343-12-0 ; the average rate of income-tax is 11 pies per rupee ; and the amount of relief (on provident fund contribution of Rs. 468-12-0 at 11 pies per rupee) is Rs. 26-13-0.

	Rs.		
Therefore the amount of income-tax for the year is	343	12	0
Less Relief in respect of P.F. contribution	26	13	0
Net yearly tax	316	15	0
Hence the amount of income-tax to be deducted monthly	26	7	0.

(b) Monthly salary Rs. 725 and the value of a free house provided by the employer Rs. 25 per month. At the beginning of the 7th month a bonus of Rs. 1,000 is also given to the employee.

The total annual income from salary estimated at the beinning of the year (when the amount of bonus is not known) would be Rs. 9,000 ; and the earned income allowance Rs. 1,800 ; the amount of income-tax chargeable on Rs. 7,200 would be Rs. 493-12-0, and the amount of monthly deduction would be Rs. 41-2-0.

For the first six months the monthly deduction would therefore be Rs. 41-2-0, but on the first day of the seventh month, owing to the grant of a bonus of Rs. 1,000, the amount of the monthly tax deduction would have to be revised thus -

	Rs.	Rs.
Total estimated annual income from salary	10,000	
Less earned income allowance	2,000	
Taxable income	8,000	
The amount of income-tax chargeable thereon		593–12–0
Less tax already deducted for six months at Rs. 41-2-0 p. m.		246–12–0
Therefore the amount of tax to be deducted in the next six months		347 0 0
Hence the amount of monthly deduction ...		57 13 0

(c) Salary Rs. 2,500 per month, the annual income from salary being Rs. 30,000.

The maximum earned income allowance is Rs. 4,000, and therefore the amount of income-tax chargeable on Rs. 26,000 is Rs. 5,375 and the amount of monthly deduction of super-tax is Rs. 447-15-0.

The amount of super-tax chargeable on Rs. 30,000 is Rs. 625, there being no earned income allowance in respect of super-tax. Therefore the monthly deduction of super-tax is Rs. 52-1-0.

The total tax to be deducted from the salary every month will be Rs. 500.

2. Interest on Securities

1. The person responsible for paying interest on securities must deduct income-tax (but not super-tax) on the amount of interest payable at the maximum rate. But if the owner of the security gets a certificate from the I. T. O. that his total income or total world income is less than the minimum liable to income-tax or is only liable to a lower rate, the person paying interest shall pay it without deduction or shall deduct income-tax at the lower rate.

2. The person paying interest on securities must give a certificate in the prescribed form containing particulars of the deduction to the person from whose interest income-tax has been deducted. He must also send to the I. T. O. a statement containing the prescribed particulars.

3. Other interest and other sums paid to non-residents

1. The person responsible for paying to a non-resident any interest (not being interest on securities) or any other sum chargeable to income-tax must at the time of payment deduct income-tax at the maximum rate, *unless he himself is liable to pay income-tax thereon as agent.* If the person to whom such payments are made is a British non-resident, and if he obtains a certificate from the I. T. O. that his total world income is less than the minimum liable to income-tax or that his total income is only liable to a lower rate, the person making such payments shall deduct it at the lower rate.

2. Super-tax on such payments made to non-residents is to be deducted at the direction of, and at the rates determined by the I. T. O.; but where no such direction is received, super-tax should be deducted at the rate appropriate to the sums payable.

4. Dividends

1. Income-tax on dividends is paid by the company direct. A dividend is deemed to be the income of the previous year of a shareholder in which it is paid, credited or distributed, and is increased by the appropriate amount of income-tax (but not super-tax) applicable thereon. The amount of income-tax, by which the net dividend is increased, is deemed to have been paid at source by the shareholder.

2. Super-tax on dividends paid to non-residents is to be deducted in the same manner as the deduction of super-tax on interest (not being interest on securities) and other sums paid to non-residents, that is to say, either at the direction of the I. T. O. and at rates fixed by him, or in the absence of such direction by the company itself at the rate applicable to the total dividend paid to the shareholder.

3. A certificate to the effect that the profits of the company out of which the dividend is paid have either been assessed to income-tax or will be assessed to income-tax, and also regarding the deduction of super-tax (if any) must be given by the company to every shareholder. A statement containing the prescribed information as to dividends paid must also be forwarded by the company to the I. T. O.

General provisions regarding deduction of tax at source:

1. All sums deducted shall be deemed to be income received by the payees.

2. Amounts deducted shall be treated as payment of income-tax or super-tax on behalf of the person from whose income they have been deducted and

credit for the same would be given to him in his assessment for the next year. In the case of a dividend, the income-tax by which it is increased, is also treated as a payment of income tax on behalf of the shareholder.

3. Where one person's income is included in the total income of another [cf. sections 16 (1) (c), 16 (3), 44-D or 44-E], credit for income-tax deducted at source is given to the latter person and not to the former.

4. The sums deducted must be paid over within a prescribed time to Government.

5. If a person fails to deduct tax, or after deducting it fails to pay it to Government, he (and in the case of a company, the company also of which he is the principal officer) shall be deemed to be an assessee in default in respect of the tax. But no penalty under section 46 (1) can be recovered from him unless such person has wilfully failed to deduct.

6. The power to levy deduction at source is without prejudice to other modes of recovery.

7. The person who deducts tax at source is bound to give a certificate of deduction except in the case of deductions from salaries. The forms of such certificates are prescribed in the Income-Tax Rules.

NOTE :—In all cases where tax cannot be deducted at source under section 18, the income is liable to direct assessment, according to section 19, in the hands of the receipient.

Test Questions

1. In which cases is income-tax and super-tax deducted at source and why ?

2. What is the difference between 'deduction of tax at source' and 'collection of tax at source' ?

3. What are the provisions with regard to the deduction of tax from payments made to non-residents ?

CHAPTER 15

PAY-AS-YOU-EARN SCHEME

Section 18 A, which provides for the pay-as-you-earn scheme, was inserted be the Indian Income-Tax Amendment Act of 1944 with a view to the prevention of inflation. This measure cannot be regarded as a temporary measure, but it would in all probability be a permanent feature of the taxation system of India.

This section deals with the advance payments of tax (both income-tax and super-tax). It applies :—

(a) to incomes from which tax is not deductible at source ;

(b) to an assessee whose total income of the latest previous year in respect of which he has been assessed exceeds Rs. 6,000 ; and

(c) to a person who has not hitherto been assessed if his total income of the previous year is likely to exceed Rs. 6,000.

In this scheme the tax is collected as and when the income is being earned, and not later in a subsequent year after the income has been earned.

Method of Advance Collection of Tax. The device adopted for the advance collection of tax is this. The assessee is required to adopt for his total income for the current year the total income as determined in his latest assessment. Excluding such portion thereof as has been subjected to deduction of tax at source, on the balance the assessee is required to pay tax during the earning year itself at the rate of tax applicable to the current financial year. The tax is to be paid in quarterly instalments. These payments are treated as advance deposits of tax and are adjusted towards the tax payable when the regular assessment is made in the usual course in respect of the current year, any excess of deficiency being refunded or collected as the case may be. The government pays simple interest at 2 per cent. per annum from the date of each payment upto the date of the regular assessment, when the deposits together with interest thereon are appropriated towards the tax assessed.

If an assessee thinks that his income during the current year will be below the income as last assessed, he can estimate his income for the current year and his tax liability therefor. He should pay the tax as estimated by him in quarterly instalments. When an assessee pays advance tax on his own esitmate, he can revise his estimate at any time before the 15th March and adjust any excess or any deficiency in the instalments previously paid.

Thus an option is given to the assessee to pay advance tax *either* on his latest assessed income *or* on his own estimate. The consequence of adopting either the first method or the second to this. In the first case he is free from any penalty, even though he may earn more during the current year and his tax liability may thus be greater than that of his latest assessment. In the second case where he chooses to pay advance tax on his own estimate, if his estimate turns out to be less than 80 per cent. of the tax as ultimately determined in the regular assessment (i. e., 80 per cent. of such tax on income which has not been subjected to tax at source), then he shall have to pay penal interest at 6 per cent. per annum on the deficiency from the 1st January of the

accounting year to the date of the regular assessment. Further, if it is found that such estimate was made by the assessee intentionally, then he becomes liable to a further penalty not exceeding 1½ times the deficit tax paid.

In both cases (i. e., payment according to the latest assessment or according to the estimate) the previous year of the assessee remains unchanged. Assessees may have different previous years for different sources of income.

Quarterly Instalments. The Income Tax Officer is empowered to make a demand on the assessee for payment in four quarterly instalments of the amount of the tax levied in the last assessment. The instalments are due on 15th June, 15th September, 15th December and 15th March. If after he had made such demand and before the 15th February in any financial year, an assessment of a later previous year than the one on which the demand was originally made happens to come into being then he may make an amended order in respect of the future instalments.

When the assessee's previous year ends after the 31st December and before the 30th April, the tax is payable in three instalments on 15th September, 15th December and 15th March.

Where any instalment due before the expiry of six months from the commencement of the previous year in respect of which it is to be paid, it shall be deemed to have become due 15 days after the expiry of the said six months. Thus, if the previous year of an assessee commences on 1st April, the first instalment will be due not on 15th September but on 16th October.

New Assessees. Persons not hitherto assessed are also bound to send an estimate of their income for the current year to the Income-Tax Officer before the 15th March in each financial year and to pay tax in advance if their income is likely to exceed Rs. 6,000.

If such an estimate turns out to be less than 80 per cent. of the tax as ultimately determined in the regular assessment, then penal interest will have to be paid on the deficiency at 6 per cent. per annum from the 1st April of the financial year to the date of the regular assessment.

Moreover, if such an estimate is not submitted to the Income-Tax Officer before the 15th March and the Income-Tax Officer is satisfied in the course of proceeding in connection with the regular assessment that such failure was without reasonable cause, he may impose a penalty equal to 1½ times of 80 per cent. of the tax determined on regular assessment.

Test Questions

1. Explain fully the provisions for the advance payment of tax known as 'Pay-as-you earn scheme' and point out the duties, benefits and the liabilities of tax-payers under this system. *(Agra M. Com. 1945)*

2. The new section 18 A of the Indian Income-Tax Act introduced by the Income-Tax Amendment Act of 1944, provides for advance payment of income-tax by laying down what is called 'Pay-as-you-earn scheme'. Discuss briefly the salient features of this scheme. *(Agra B. Com. 1947)*

3. A person set up a new business on 1st August 1947. If his first assessment is made in 1946-47 on an income of Rs. 10,000 and it is found that he did not pay any advance tax under section 18 A, would you impose any penalty and charge any penal interest? From what date would the interest, if any, be chargeable? *(Income-Tax Departmental Exam. 1946)*

CHAPTER 16

SUPER-TAX

Super-tax is an additional duty of income-tax and is levied at the rates specified in the Finance Act passed annually. It is charged on the total income (subject to adjustment in respect of capital gains, if any). It is levied on the following assessees, viz.,

1. Individual ;
2. Hindu Undivided Family ;
3. Company ;
4. Local Authority ;
5. Unregistered Firm ;
6. Other Association of Persons (not being a registered firm) ; and
7. Partners of a firm or members of an association individually.

Registered firms are not assessed to super-tax, but the partners of such firms are assessed to super-tax on their partnership profits along with their other income. An unregistered firm, which has been assessed as a registered firm under section 23 (5) (b) is treated like a registered firm for super-tax purposes.

It should be noted that where an unregistered firm or other association of persons (not being a company) is itself assessed to super-tax the share of the profits of a member of the unregistered firm or other association of persons will be excluded from his total income for super-tax purposes.

Liability to Super-tax. In the case of an assessee (not being a company), the super-tax is levied on his total income minus capital gains as if such reduced income were his total income. But in the case of a company, the super-tax including additional super-tax will be charged on the total income of the company (inclusive of capital gains which exceed Rs. 15,000), and then the total amount of super-tax thus computed will be reduced by the amount of super-tax computed on that part of its total income which consists of capital gains at the rate of super-tax excluding the rate of additional super-tax, if any.

It should be noted that all assessees except companies and local authorities are not liable to super-tax unless their total income exceeds Rs. 25,000. But the super-tax on companies and local authorities is lieved at a flat rate on their total income, whatever its amount may be. No refund on account of company super-tax is allowable to shareholders, because the super-tax on companies is levied on account of the special privileges which companies enjoy by statute in the shape of corporate finance and limited liability. The super-tax payable by companies is known as *corporation tax.*

Super-Tax on Income partly Earned and partly Unearned. In making any assessment for the year ending on 31st March 1948 ; where the total income of an assessee consists partly of earned income and partly of unearned income the super-tax payable by him will be calculated as follows :—

(a) Where the total income of an assessee, not being a company, includes any income chargeable under the head salaries on which super-tax has been or might have been deducted, the super-tax payable by the assessee on salaries will be proportionate to the total amount of super-tax payable at the rates in force in the year in which tax has been or might have been deducted at source ; *plus*

(b) On the remainder of the earned income, the amount of super-tax payable thereon will be proportionate to the total amount of super-tax which would have been payable on the total income had it consisted wholly of earned income at the rate in force in the year of assessment ; *plus*

(c) On the unearned income, the amount of super-tax payable thereon will be proportinate to the total amount of supe-tax which would have been payable on the total income had it consisted wholly of unearned income at the rates in force in the year of assessment.

Deduction of Super-Tax at Source: Super-tax is payable by an assessee direct except in the following cases where it is deducted at source :—

1. Super-tax is deducted on salaries at a rate representing the average of the rates applicable to the estimated income of the employee under the head salaries only, whether the employee is a resident or a non-resident.

2. *Super-tax on interest (not being interest on securities) and other sums* chargeable to tax paid to a non-resident is to be deducted at the direction of and at the rate determined by the I. T. O. ; but where no direction has been received from the I. T. O., it should be deducted at the rate appropriate to the excess of the sums payable over the exemption limit for super-tax. Thus, if the payee is an individual, the appropriate rate of super-tax should be calculated on the excess over 25,000 of such payment ; but if the payee is a company, it should be deducted at the prescribed rate even if the sum paid is one rupee only.

3. *Super-tax on dividends paid to non-resident* is to be deducted in the same manner as super-tax on interest and other payments explained above viz., either at the direction of the I. T. O. and at rates determined by him, or, in the absence of such direction, by the company at the rate applicable. When the non-resident payee is a company, super-tax should be deducted, whatever the amount of dividends paid may be.

Illustration

For the year ended 31st March 1947, the taxable income of X consisted of Rs. 30,000 from salary, Rs. 15,000 from property, Rs. 15,000 from business and Rs. 50,200 capital gains. Ascertain the amount of tax payable by him for the assessment year 1947-48.

X's Assessment for 1947–48

		Income	I. T. collected at source
		Rs.	Rs.
1. Salary	...	30,000	6,000
2. Property Income	...	15,000	
3. Business Profits	...	15,000	
4. Capital Gains	...	50,200	
Total Income	...	1,10,200	
Less Earned income allowance		4,000	
Taxable Income	—	1,06,200	

			Rs. a. p.
Gross income-tax on Rs. 56,000	...		14,,750 0 0
Gross income-tax on Rs. 50,200	...		3,225 0 0
Gross super-tax :			
On salary of Rs. 30,000	...	3,437 8 0	
On remaining earned income of Rs. 15,000	...	1,835 15 0	
On earned income of Rs. 15,000		2,382 13 0	7,656 4 0
			25,631 4 0
Less tax collected at source	...		6,000 0 0
		Net tax payable Rs.	19,631 4 0

Test Questions

1. What is super-tax and how is it assessed? When is super-tax deducted at source?

2. How would you calculate super-tax on the total income of an individual when such income is partly earned and partly unearned?

CHAPTER 17

ASSESSEES

An assessee is a person by whom tax is payable. Under section 3, the income of every individual, Hindu undivided family, company or local authority, and of every firm or other association of persons or the partners of the firm or the members of the association individually is assessable to income-tax.

This section defines *(a)* who has to pay, i. e., every individual, Hindu undivided family, etc., *(b)* on what he has to pay, i. e., the total income of the previous year, and *(c)* at what rates, viz., the rates fixed by the Finance Act passed every year by the Central Legislature.

Section 4 circumscribes the scope of section 3 by defining and limiting the nature of the income that may be included in total income section 7-13 lay down the manner of computing the taxable income of an assessee from various sources.

1. Individual.

The term 'individual' refers only to a human being. An individual is assessed to income-tax and super-tax at a graded scale of rates according to the amount of his total income, if that exceeds Rs. 3,000.

A married woman is separately assessed in respect of her separate income. A minor who earns an income by his own skill is capable of making a return of total income and of paying the tax, and if he has no guardian he does not escape assessment, but is liable personally and can be assessed as an individual.

2. Hindu undivided families.

A Hindu undivided family is one which possesses the following four essentials, namely, *(a)* common nucleus of ancestral property; *(b)* common mess; *(c)* common fund; and *(d)* common worship. A Hindu undivided family is different from a Hindu coparcenary. A Hindu coparcenary is a special feature of the Mitakshara School of Hindu Law, while there is strictly speaking no coparcenary under the Dayabhag School. But the undivided family is a common feature of both the Schools.

A Hindu undivided family is treated and taxed (through its manager or karta) as a separate entity like an individual according to its total income, and no account is taken of how that income is distributed amongst the individual members, when such individual members are assessed to income-tax or super-tax in respect of their separate income. This applies even in cases where the amount of the income of the Hindu undivided family is less than the minimum taxable limit, and is therefore not liable to taxation in the hands of the manager of the family. The same remarks apply to super-tax.

Where the income, profits and gains of a member of a Hindu undivided family consist of his personal earnings, they are treated as his personal income and not as joint family income unless they flow from the employment in business or otherwise of the joint family property.

Jain and Sikh undivided families will be treated as Hindu undivided families, unless in any particular case, the assessee claim that they should not be treated as such. Where such a claim is put forward, it is for the assessee to prove the existence of some special custom or practice applicable to the family in question which would justify its not being treated as a Hindu undivided family.

The son of a Hindu (governed by any school of Hindu law) does not acquire by birth any interest in his father's self-acquired property. In respect of the income of such property the father is to be assessed as an individual.

In the case of Hindu not governed by the Dayabhaga law the son acquires by birth an interest in his father's ancestral property and therefore after the birth of a son the income from ancestral property is to be assessed as the income of a Hindu undivided family. According to the Dayabhaga law, however, the son does not acquire by birth any interest in ancestral property. His rights arise for the first time on his father's death. In the father's life time, therefore, the income from ancestral property is to be assessed as the income of an individual unless the father himself is a member of a coparcenary.

The income of a sole surviving male member of a Hindu undivided family governed by the Mitakshara law is to be assessed as his personal income if he has no son. The existence of a wife and daughters does not alter the position. Under the Dayabhaga law the position is different. According to that law a coparcenary is formed only when the inheritance opens and there must be two or more male heirs before a coparcenary can be formed. But if any of these male coparceners dies leaving surviving him a widow or a daughter that widow or daughter would be admitted into the coparcenary in the place of the deceased coparcener. If, for example a Hindu governed by Dayabhaga law dies leaving three sons A, B and C, the three sons A, B and C, inherit the property jointly and form a coparcenary (although each inherits a defined share). If before partitioning their shares, B dies leaving a widow, BW, and C, dies leaving a daughter CD, then A, BW, and CD, will be members of the coparcenary originally formed by A, B and C. It will thus be seen that the Dayabhaga law differs from the Mitakshara in admitting females into the coparcenary in certain circumstances although they cannot originally form a coparcenary. A coparcenary is a *fortiori* a Hindu undivided family and the income from the coparcenary property will, according to the Dayabhaga law, be assessable as the income of a Hindu undivided family notwithstanding that such coparcenary consists of only one male member and one or more female members.

The income from the ancestral property of a Hindu (governed by any school of law) with no son but with a wife and / or daughters is assessable as the income of an individual.

Assessment after partition.—Section 25-A applies only when a member of a Hindu undivided family claims (at or before the time of assessment) that it has become divided, and if the I. T. O. is satisfied he will pass an order to this effect. Such an order can be passed only *(i)* the member of the family have separated in status from each other and *(ii)* there has been a partition of all the joint family property. So long as such an order is not passed by the I. T. O. a Hindu undivided family will continue as undivided.

If, however, a Hindu undivided family prefers to go on being assessed as undivided though really divided the I. T. O. has no authority to act under this section.

When an order for the partitions of a Hindu undivided family has been passed by the I. T. O., the I. T. O, should assess the total income of the family as

if no partition had taken place, and the appropriate share of each member should be included in his total income and assessed accordingly, notwithstanding the provision of section 14 (1). The various members of the divided family will be jointly and severally liable for the total tax due.

The same procedure will apply even if the business or profession of the family (whose property has been partitioned) has been succeded to by another or by the members of the family who form themselves into a firm.

2. Companies.

The term 'company' means any incorporated, chartered or statutory company and a company incorporated in any other British territory or in an Indian State. It also includes any foreign association carrying on business in British India (whether incorporated or not) which has been declared to be a company by the Central Board of Revenue. The term 'Indian Company' means a company as defined in the Indian Companies Act of 1913, the registered office of which is situated in British India.

As regards income-tax—A company is assessed to income-tax at the rates prescribed by the Indian Finance Act ; and a dividend received by a shareholder is grossed up by adding to it the appropriate amount of income-tax applicable thereto, and credit for the amount of this income-tax is then given to the shareholder in his separate assessment.

The whole of the dividend is taxable in the hands of the shareholder even though a part of it may have been derived from non-taxable sources, e. g., agricultural income or tax free interest from grovernment securities. All that he can claim is that the notional tax addition to be made to the dividend shall be proportionate, if a part of the company's income has been derived from non-taxable sources.

As regards super-tax—A company pays a flate rate of super-tax on the whole of its total income. This tax is in no sense paid on behalf of shareholders, nor is a refund allowed to them as in the case of income-tax. This is a tax for the privilege which companies enjoy in the shape of limited liability and corporate finance. This is also known as corporation tax.

A company holding shares in another company is liable to pay super-tax again on the dividends received by it, though by special exemption under section 60 investment trusts have been relieved from this liability.

Prevention of avoidance of super-tax—(1) In order to avoid super-tax which would be payable by the shareholders, profits of companies are often accumulated and capitalised and then distributed to the shareholders in various capital forms, e. g., bonus debentures or by reduction of capital. The term 'dividend' has now been defined in such a way as to prevent this practice.

(2) A company may, however, attempt to avoid the operation of the definition of dividend by making no distribution whatever either in a capital or in an income form, but its efforts in this direction are checked by the revised section 23-A. This section lays down that if dividends are less that 60 per cent. of the assessable income as reduced by the amount of income-tax and super-tax payable by the company thereon the I. T. O. can deem the whole profits to have been distributed and the proportionate share thereof of each shareholder would be included in his total income.

Where the reserves of past undistributed profits exceed the capital of the company (including the loan capital belonging to the shareholders) or they exceed the cost of the fixed assets of the company, then 100 per cent. is substituted for 60 per cent.

There are, however, three mitigating provisions, viz—*(i)* That the I. T. O. will not pass such an order if he is satisfied that having regard to past losses or to the smallness of the profits, distribution would be unreasonable; *(ii)* There are certain conditions in which, if the distributions are not less than 55 per cent., time will be given to increase the distribution to over the 60 per cent. limits; and *(iii)* That the section is not to apply to subsidiary companies and companies in which the public are substantially interested.

A company in which the public are substantially interested is one whose shares carrying not less than twenty-five per cent. voting power are at the relevant period held by the public and have been quoted in any stock exchange in British India, or are freely transferable among the public. Such share do not include shares carrying a fixed rate of dividend, even though they may participate further in profits. The relevant date to ascertain whether the required quantity of shares were held by the public is the end of the previous year, i. e., the particular profit year, the subject-matter of the investigation.

(3) Dividends paid outside British India out of profits subjected to income-tax in British India are deemed to arise in British India and are therefore liable to super-tax whether the owner is resident in British India or not—Section 4 (1).

Managing agency commission,—Section 12—A provides that where a managing agent of a *company*, under the terms *of an agreement made for adequate consideration*, parts with a portion of the managing agency commission each party to the agreement is, *on the filing of a declartion and on satisfactory proof of the facts*, to be taxed only in respect of the amount which he is entitled to retain under the agreement. The words which have been italicized are of the utmost importance in this respect.

4. Local authorities.

A local authority such as a municipal board, district board, post trust, improvement trust, etc.) is taxable in respect of that income which it makes from the supply of commodities or services outside its own jurisdictional area. It is assessed both to income-tax and super-tax exactly like a company.

5. Firms.

The terms "firms," "partner," and "partnership," have the same meanings respectively as in the Indian Partnership Act, 1932. But for income-tax purpose a minor admitted to the benefits of a partnership is included in the term partner.

For taxation purposes firms may be registered or unregistered. A registered firm means firm registered under the provisions of section 26—A, and an unregistered firm means a firm which is not a registered firm.

How to register a firm.—In order to register a firm under section 26—A, an application in the prescribed form has to be made to the I. T. O. A firm to be registered must be constituted under an instrument of partnership which definitely specifies the individual shares of the partners in the profits of the firm. An application for registration may be made at any time before the assessment of the income of the firm is made. A certificate of registration has effect only for the assessment to be made for the year mentioned therein.

(a) Assessment of a Registered Firm

As regards income-tax—In the case of registered firm its total income has to be assessed upon it, but the amount of income-tax payable by the firm itself has not to be determined. The total income of each partner inculding his partnership profit from the registered firm has to be assessed upon him and the tax payable by him has accordingly to be determined.

The only exception is in the case of a partner who is not resident in British India, and in such a case the partnership profit of the non-resident partner has to be assessed on the firm and the sum payable has to be determined at the rate which would be applicable if the same income had been assessed on him personally.

There is also provision that where the tax assessed upon a partner cannot be recovered from him it shall be recovered from the firm.

As regards super-tax.—A registered firm as such is not liable to super-tax. The share of each partner in the firm's income is added on to his other income, and he is then individually assessed to super-tax.

Set-off and carry-forward.—The loss of registered firm is in the first instance to be set off against its own income, and then the balance of the loss allocated between the partners, each of whom can set off his share of the firm's loss against his other income in the current year or can carry it forward as a business loss under section 24 (2).

Wrong distribution of profits.—If the profits of a registered firm have been distributed otherwise than in accordance with the share of the partners as shown in the instrument of partnership, and any partner has thereby returned income below its real amount; the I. T. O. can impose penalty under section 28 (2) on the partner concerned and no refund or other adjustment would be claimable by any other partner on this account.

Earned income relief.—In the case of a registered firm or a firm treated as registered under section 23 (5) (b) of the Act, as the tax is not payable by the firm on its own behalf, relief, is admissible to the partners by whom tax is payable and who are the assessees. Where a registered firm is assessed under the second proviso to section 23 (5) (a) in respect of the share of income of a non-resident partner; the earned income allowance appropriate thereto would be admissible in determining the tax payable by the firm on behalf of the partner provided the partner is actively engaged in the conduct of the business of the firm.

(b) Assessment of an Unregistered Firm

As regards income-tax.—An unregistered firm is assessed like an individual according to the amount of its total income. If the total income does not exceed Rs. 2,500 no income-tax is payable.

The partners are not entitled to refund nor are they taxed on the profits from an unregistered firm if it has been taxed; but their shares in the profits of the unregistered firm are included in their 'total income' for fixing the rate at which they should pay tax on their individual incomes. But if an unregistered firm as such pays no tax (its total income not exceeding Rs. 2,500) the partners are liable to pay tax on their respective shares along with the tax on their other incomes.

As regards super-tax.—An unregistered firm is also assessed to super-tax like an individual, and super-tax is not payable by the partners on their shares of the firm's income, unless the firm itself is not assessed to super-tax.

Set off and carry-forward.—An unregistered firm as such can set off its own loss against its own income, or can carry it forward as a business loss under section 24 (2) but a partner of an unregistered firm is not allowed to set off his share of the firm's loss against his other income.

Earned income relief.—If an unregistered firm is not liable to pay any tax because its income is below the taxable minimum, the appropriate earned income allowance in respect of his share of profits of the firm would be admissable to any partners who were actively engaged in the conduct of the business of the firm.

(c) An Unregistered Firm treated as Registered

Under section 23 (5) (b) an I. T. O. can treat an unregistered firm as registered, if more tax (income-tax and super-tax) would be payable as a registered firm. This is intended to prevent avoidance of tax by non-registration.

When an unregistered firm has been treated as a registered firm by the I. T. O. all the provisions applicable to a registered firm would also apply to it.

Allocation of a firm's income or loss between the partners.—According to section 16 (1) (b), a partner's share of the firm's profit or loss should be taken to be any salary, interest, commission or other remuneration payable to him by the firm, increased or decreased respectively by his share in the balance of the profit or loss of the firm.

Illustrations

1. *A*, *B* and *C* are equal partners in a firm whose Profit and Loss Account shows a net trading loss of Rs. 3,600 after charging the following: Interest on *A*'s Loan Rs. 2,000; *B*'s salary Rs. 1,000; and *C*'s commission Rs. 1,600.

What is the total income of the firm and how would you divide it between the partners?

Interest on *A*'s Loan	...	2,000
B's salary	...	1,000
C's commission	...	1,600
		4,600
Net Loss as per P. and L. account	...	3,600
Total income of the firm	Rs.	1,000

Allocation between the partners

	A	B	C
Interest on Loan	2,000	—	—
Salary	—	1,000	—
Commission	—	—	1,600
Balance	–1,200	–1,200	–1,200
	Rs. 800	–200	400

2. A, B and C are in partnership sharing ½, ⅓ and ⅙ respectively. The following is the P. & L. Account of the firm.

Trade Expenses		... 58,920	Gross Profits	... 2,10,000
Bad Debts		... 2,400		
Interest on A's Loan		... 1,800		
Salary : A	18,000			
B	12,000	... 30,000		
Interest on Capital ;				
A	6,000			
B	7,200			
C	3,600	... 16,800		
Building Extension		... 8,280		
Net Profit : A	45,900			
B	30,600			
C	15,300	... 91,800		
	Rs.	2,10,000	Rs.	2,10,000

Find out the taxable profits of the firm and allocate them between the partners.

Gross Profit as per P. & L. Account		2,10,000
Less Trade Expenses	58,920	
Bad Debts	2,400	61,320
Total income of the firm	Rs.	1,48,680

Allocation between partners

	A	B	C
Interest on Loan ...	1,800	—	—
Salary ...	18,000	12,000	—
Interest on Capital	6,000	7,200	3,600
Balance ...	50,040	33,360	16,680
Rs.	75,840	52,560	20,280

3. A and B are equal partners in a registered firm whose Profit & Loss Account for the year 1946 is as follows :—

	Rs.		Rs.
Business Expenses ...	6,000	Gross Profit ...	10,800
Interest on Capital : A ...	2,000	Interest on securities ...	1,320
B ...	1,000	Net Loss : A ...	990
Salary to A ...	1,200	B ...	990
Commission to A ...	1,500		
Charity ...	500		
Bad Debts ...	900		
Bad Debts Reserve ...	1,000		
	14,100		14,100

Calculate the total income of the firm and allocate it between the partners.

			Rs.
Gross Profit as per Profit & Loss Account		...	10,800
Less Business Expenses ...	6,000		
Bad Debts ...	900		6,900
Taxable income from business		...	3,900
Interest on securities		...	1,920
Firm's total income		...	5,820

This will be allocated between A and B thus :

		A	B
		Rs.	Rs.
Interest on Capital	...	2,000	1,000
Salary	...	1,200	—
Commission	...	1,500	—
Balance	...	-900	-900
		3,800	100
Interest on securities	...	960	960
		4,760	1,060

(b) Change in the Constitution of a Firm

Section 25 (1) provides that where a change has occurred in the constitution of a firm or where a firm has been newly constituted, the assessment is to be made upon the firm as constituted at the time the assessment is made, but the profits are to be apportioned among the persons who were partners in the previous year and not among the partners entitled to the profits at the time of assessment. Thus each partner is taxed only in respect of the profit to which he was actually entitled in the previous year.

If, however, the tax assessed upon a partner cannot be recovered from him it shall be recovered from the firm as constituted at the time of making the assessment.

Further, where, a change has occurred in the constitution of a firm, *only* the person actually incurring the loss is entitled to set it off against his income.

(c) Dissolution of a Firm

Where a besiness belonging to a firm is discontinued, section 44 provides that the persons who were members of the firm on the date of such discontinuance are jointly and severally liable to any tax due from the firm.

6. Other associations of persons.

The word association simply means a group. An association of person (not being a company or firm of Hindu undivided family or a local authority) is an association of companies, firms and other bodies of individuals, e. g., a chamber of commerce, a club, etc.

An association of persons is assessed to income-tax and super tax exactly in the same way as an individual,

But where a business belonging to an association of persons is discontinued or when an association of persons is dissolved, section 44 provides that the persons who were members of such association on the date of such discontinuance or the date of dissolution are jointly and severally liable to any tax due from the association.

7. Guardians, Trustees, etc.

Section 40 makes the guardian, trustee or agent of a minor, lunatic, idiot or a non-resident liable to be assessed on any income which such guardian, trustee, or agent is entitled to receive on behalf of the beneficiaries concerned, while section 41 makes the Court of Wards, the Administrator-General, the Official Trustee, etc., appointed by or under the orders of a Court or any trustee appointed under a duly executed trust deed liable to be assessed on the income which such Courts of Wards, etc., are entitled to receive on behalf of beneficiaries.

Under either section the liability to assessment is to be in the same manner and to the same extent as it would have been had the assessment been made on the beneficiary.

The proviso to section 40 provides (as an alternative) for direct assessment of a beneficiary who is a non-resident, while section 41 (2) gives the Income-Tax Officer the right to assess the beneficiaries direct notwithstanding the substantive provisions of this section. Whilst the amount of tax payable is not affected, it will frequently be more convenient, particularly where a beneficiary has other income, for the assessment to be made on him and not on the trustee.

Where a trust does not define the shares of the beneficiaries, the tax is leviable and recoverable at the maximum rate.

Where any property (in the widest sense and including a business) is held under trust, the owner of that property, for the purposes of the Income-Tax Act, if the beneficiary and the income is the income of the beneficiary. The Act does not permit of double taxation in the case of trusts, and again in the hands of a beneficiary.

Test Questions

1. How is a Hindu undivided family assessed to tax? Compare the assessment of a Hindu undivided family with that of an unregistered firm.

2. Write a short essay on "The Taxation of a Company".

3. What are the provisions of law designed to prevent the avoidance of super-tax by the shareholders of a company?

4. Under what circumstances can the Income-Tax Officer assess the income of certain companies in the hands of the shareholders although in fact no dividend may have been actually distributed by those companies? Why, in your opinion, has this provision been made under section 23-A of the Income-Tax Act? *(Agra M. Com. 1947)*

5. How would you make assessment in the following case? X is a non-resident partner of a registered firm. His share from the firm is Rs. 10,000. His other income in British India is Rs. 6,000. He is the subject of an Indian State in which his income is Rs. 20,000.

6. What is a company under the Indian Income-Tax Act? Do the Income-Tax Act and the Finance Act 1946 make any distinction in the assess-

ment of a public and a private company? If so, what? What is the criterion laid down for determining whether a company is a public or a private company?

7. X, Y, Z, has been assessed as a registered firm and the appropriate share allocated for direct assessment in the partners' hands. In assessing the partners it is found that Y's share was actually credited in the Bank account of X and that Z was not really a partner. It is to the Income-Tax Officer to cancel registration and to reallocate the shares properly?

8. What is a registered firm according to the Indian Income-Tax law, and how is registration effected? What is the difference between the taxation of registered and unregistered firms? *(Agra B. Com. 1946)*

9. A firm having two equal partners A and B suffered a loss of Rs. 30,000 during its accounting year ended 31st March 1946, as under:

Business profits after paying interest of Rs. 10,000 to partner A on his capital		Rs. 50,000
Loss from a leasehold property		80,000
	Net loss	30,000

Partner A had during that year an income of Rs. 25,000 from house property and partner B who had no income that year claimed a loss of Rs. 10,C00 brought forward from the preceding year from his individual cloth business which was closed on 31st March 1945.

Compute the total income of each partner assuming the firm to be
(i) Registered.
(ii) Not registered, nor assessable under section 23 (5) (b) of the Income-tax Act in the manner applicable to registered firm.
(Income-Tax Departmental Exam. 1946)

10. State the essentials which constitute a Hindu undivided family for income-tax purposes. What is its position in the scheme of taxation to income-tax and super-tax? *(Agra M. Com. 1948)*

CHAPTER 16

NON-RESIDENTS

As stated in Chapter 2, a non-resident is taxed on all his income accruing, arising or received in British India or deemed to accrue, arise or to be received in British India. Section 42 (1) lays down that all incomes, profits or gains accruing or arising through or from any *business connection, property, asset or source of income* in British India, or through or from *any money lent at interest and brought into British India* in cash or in kind or any capital gains made in British India shall be deemed to accrue or arise in British India.

That is to say, a non-resident is liable to tax in respect of that income which arises *in a primary sense* in British India, even though it may technically arise abroad because it is payable abroad, *e. g.*, salary payable abroad but earned in British India, or interest on loan from a non-resident brought into British India though the interest may be payable abroad, or that part of a dividend paid abroad which is derived from profits taxed in British India. The only exception is that provided in Explanation 2 of section 4 (1) for pensions payable without India (not British India).

It should be noted that if a non-resident has a business connection in British India, he is taxable only in respect of that part of the profit made out of the connection which is attributable to the operations in British India. Thus, if a non-resident's business consists of buying goods in British India and selling them in a foreign country, he will be assessable (either directly or through an agent) only in respect of that part of the profit which is attributable to the buying operations. If, on the other hand, the business consists of buying goods abroad and selling them in British India, the full profits arise in British India and are taxable, because the profits have been created by sales and the sales have taken place in British India.

Indian branches of non-resident firms are liable to assessment, and in order to secure an accurate assessment in such cases the I. T. O. requires the production of the profits and loss account and balance sheet of the firm as a whole in addition to that of the Indian branch, and also the submission of a detailed statement of all the profits credited to the head office on account of transactions carried out on its behalf. Where, however, owing to faulty book-keeping, the profits of the Indian branch cannot be gauged accurately, the I. T. O. has wide powers to determine how the profits of the Indian branch should be calculated. He can fix as the income of the Indian branch for assessment purposes either a percentage of the turnover of the business done by the branch or, where this procedure proves unsuitable, an amount which bears the same proportion to the total profits of the business as the Indian receipts bear to the total receipts of the business, or in such other manner as he deems suitable.

Indian agents of non-resident firms of which they are not technically either branches or subsidiary firms are liable on account of their principals for the the payment of tax on their principals' Indian profits. The profits of a non-resident are *not* taxable if the business operations in which he is engaged consist entirely of trading *with* British India as distinct from trading either wholly or partially *in* British India. For example—

1. A distiller in Glasgow sells whisky direct to *A*, an importer in Bombay. The relationship is that of principal and principal and not that of principal and agent. Moreover as the distiller has no agent or connection in British India he must be treated as trading *with* British India.

2. A, an Indian resident and a large supplier of mill stores, has a monopoly for the sale in India of the belting of a non-resident *B*. *A* is paid commission by *B* on all orders executed. So long as *B* exercises any control over the pricing of the goods or the method by which his agent *A* conducts the business, he must be deemed to have a business connection in British India and is assessable accordingly either direct or through an agent.

3. If, on the other hand *B* sends the goods to *A* for sale at the best prices obtainable *A* undertaking for a commission to sell entirely at his own discretion (how he likes and to whom he likes) and *A* bearing any bad debts, then *B* is really trading *with* British India.

4. A is the Indian agent for hardware and sundries of *B* a British manufacturer. A receives salary and commission from *B* and bad debts fall on *B*. Here *B* is actually trading *in* British India through his employee, and quite clearly he is liable to tax either directly or through any person including his employee *A*) who may be deemed to be his agent.

Mode of assessment. The assessment of a non-resident may be made either in his own name or in the name of his agent, and in the latter case such agent shall be deemed to be the assessee in respect of such income-tax.

Agents for non-residents—Section 43 contemplates three classes of persons who may be treated as agents of a non-resident :

(i) Any person employed by a non-resident ;
(ii) Any person having a business connection with the non-resident ; and
(iii) Any person through or from whom the non-resident is in receipt of any income.

But the I. T. O. must serve on the resident person a notice of his intention of treating such person as the agent of a non-resident thus giving him an opportunity of being heard as to his liability : and if the resident person treated by the I. T. O. as the agent of a non-resident is dissatisfied with the I. T. O.'s order, he has the right to appeal.

Note.—A broker who is carrying on ordinary broking business *through non resident brokers* cannot be deemed an agent in respect of such transactions. The foreign principal is, of course, liable to tax in respect of profit made in British India ; and while the broker cannot be appointed as agent, the non-resident principal would be assessed direct, nor is any person resident in British India relieved from the responsibility of deducting tax under section 18 (3A) in all cases in which that subsection is applicable.

Capital gains arising from sale of capital assets in British India will be deemed to be income accruing or arising in British India. Under section 43, a person, to whom a non-resident sells, after 28th February 1947, his capital asset in British India, shall be treated as his agent. Such a person shall be deemed to have a business connection with such person residing out of British India.

When a person has been treated as the agent of a non-resident for purposes of income-tax, he has a right to deduct from payments to the non-resident the tax which he estimates he will have to pay over on the profits made in British India by the non-resident. If the non-resident principal and the resident agent cannot agree on the estimated amount to be retained, the resident person can get a certificate from the I. T. O. of the amount which is

considered reasonable to be retained pending settlement of the matter, and if he obtains such certificates he will not be liable to pay tax as agent for any greater sum.

Deduction of tax from payments to non-residents.—As already explained in Chapter 14, tax must be deducted from all payments to non-residents of salary, interest, royalty, commission or any other sum chargeable to tax, and the tax so deducted must be paid over to Government. Where the amount in question is payable abroad (so that the payer in British India cannot under his contract deduct Indian tax) no allowance is to be given for the payment in the assessment of the income of the payer. But in all cases the salary or interest or other sum must be chargeable to tax, otherwise no question of deduction of tax, or disallowance in the payer's account arises.

Determination of tax payable by non-residents.—Section 17 (1) lays down the basis on which the tax is calculated on a non-resident's income which is chargeable. For this purpose non-residents are divided into *(i)* British subjects, including subjects of Indian States or States in Burma or of any part of the British Dominions or Colonies ; and *(ii)* all other non-residents. For both these classes of non-residents the amount of tax is determined as follows :—

1. The rate of income-tax for British non-resident is computed by reference to his "total world income" (i. e., the whole of his income wherever arising but derived from sources to which the Act applies). *No tax is however, payable if the total world income does not exceed Rs. 2,500 except in the case of a non-resident company to which this exemption limit of Rs. 2,500 is not applicable.*

2. A non-British non-resident pays income-tax at the maximum rate, however small his total income may be. He is not entitled to the benefit of the exemption limit of Rs. 2,500. Thus if his income arising in British India is Rs. 500 only he will pay income-tax at the rate of 60 pies per rupee.

3. The super-tax payable by any non-resident—British or non British—is computed by reference to his total world income.

Recovery of tax.—Where the tax payable by a non-resident has not been deducted at source or where there is no resident agent from whom it may be recovered, any arrears of tax may be recovered from any assets of the non-resident which are or may at any time come within British India. *There is no time limit to such recovery.*

Double taxation relief - In many cases a non-resident pays tax twice on certain portions of his income—in his own country as well as in British India. Therefore to afford some relief in such cases, there are arrangements for double taxation relief with the U. K., Burma, Ceylon, Aden and certain Indian States, so that the whole burden of tax on the foreign income does not fall upon the assessee.

The provisions governing double taxation relief, which are very complicated, are contained in section 49 to 49 D. These have been ignored in this book.

Illustration

A is resident of the Gwalior State. On 1st April 1943 he purchased house property worth Rs. 2,00,000 in Agra. He also advanced a sum of Rs. 1,00,000 to an Agra firm on the same day at 5% per annum interest. The property fetches him an income of Rs. 1,000 per month as rent.

According to the instructions of A, the rent and interest due to him are remitted by the tenants and the Agra firm direct to him at Gwalior. When required to submit his return for purposes of income-tax assessment, A denies his liability to tax on the ground that the income is received by him direct in the State and the money was also advanced by him in the State and that he has no business connection to British India.

How will you proceed with the assessment of A and how can the tax, if any, levied on him be recovered ? *(Agra M. Com. 1946)*

A is a non-resident, but his British Indian income liable to tax is Rs. 15,000—Rs. 10,000 from property (Rs. 12,000 rent minus one-sixth allowance for repairs) and Rs. 5,000 from interest. A's assessment may be made either in his own name or in the name of his agent through whom he has received the rent and interest.

The Income-Tax Officer must serve on the resident person a notice of his intention of treating such person as the agent of A, thus giving him an opportunity of being heard as to his liability.

The person treated as the agent of A for purposes of income-tax has a right to deduct from payments to A the amount of tax which he estimates he will have to pay over on A's British Indian income.

As A is a British non-resident, he will pay both income-tax and super-tax at the average rates of income-tax and super-tax applicable to his total world income.

When the tax payable by A has not been deducted at source or when there is no resident agent from whom it may be recovered, any arrears of tax can be recovered from any assets of the non-resident which are or may at any time come within British India. There is no time limit to such recovery.

Test Questions

1. Which income of a non-resident is liable to tax in British India ?

2. How is the amount of income-tax and super-tax payable by a non-resident calculated ?

3. Under what circumstances can a person be appointed as the agent of a non-resident principal ? In examining the accounts of a broker in British India a number of payments made to a New York broker on account of speculation profits are noticed. What steps, if any, would you take either to assess such profits or to recover from the payer the tax that in your view ought to have been deducted under section 18 (3A) ?

4. How will you determine the income-tax and super-tax liability in the following cases ?—

(a) A non-resident British subject with income both within and without British India ;

(b) A non-resident British subject with Indian income and foreign loss ;

(c) An individual with share in an unregistered firm assessed to income-tax only but not to super-tax.

CHAPTER 19.

ASSESSMENTS (I)

The I. T. O. is the assessor. He makes the assessment. The term assessment means the determination of *(i)* the total income of an assessee and *(b)* the amount of tax payable by, or refundable to, him. The assessment proceedings are initiated with the Return of Total Income to be filed by the assessee.

Return of Total Income. – Section 22 (1) requires an I. T. O. to publish general notices in the press calling upon every person within his jurisdiction to make a return of his total income exceeding Rs. 3,000 in the previous year. He is also to send an individual notice, under Section 22 (2) to every person whom he believes to have an income liable to assessment.

The return of total income is to be made in a prescribed form, a copy of which can be obtained from the Income-Tax Office.

If a person fails to furnish a return of total income within the time specified in the notice, he may furnish it at any time before the assessment is made. Should there be any error or omission in the return already submitted, the assessee may furnish a revised return at any time before the assessment is made.

Failure to furnish the return of income without reasonable cause involves a penalty which can be as much as one and half times the tax payable—to be paid in addition to the tax itself. But no penalty can be imposed on an assessee whose total income is less than Rs. 3,500 or upon the agent of a non-resident unless he has been served with an individual notice.

If a person has received an individual notice to make a return but refuses to do so, a penalty up to Rs. 25 can be imposed upon him if he proves that his total income is less than Rs. 3,000.

The Assessment

Section 23, under which assessments are made, contemplates three kinds of assessments :

1. Where the I. T. O. is satisfied that the return of income is correct and complete, he assesses the total income of the assessee and determines the amount of tax on the basis of such return.

2. Where the return of income is believed to be incomplete and the assessment is made after an enquiry, the next step to be taken by the I. T. O. is the service of a notice under section 23 (2) on the assessee requiring him on a date therein specified either to attend at the Income-tax Office or to produce any evidence in support of his return. If the I. T. O. wishes the assessee to attend personally he can insist on this by issuing an order under section 37.

Under section 22 (4) the I. T. O. can also call upon any person who has made a return to produce such accounts and documents as he may require, but the I. T. O. cannot call upon an assessee to produce books of account going back for a period of more than three years prior to the previous year on the profits of which the assessment is based.

In this way, when the I. T. O. has satisfied himself, he makes the assessment and determines the tax to be paid by the assessee.

According to the instructions of A, the rent and interest due to him are remitted by the tenants and the Agra firm direct to him at Gwalior. When required to submit his return for purposes of income-tax assessment, A denies his liability to tax on the ground that the income is received by him direct in the State and the money was also advanced by him in the State and that he has no business connection to British India.

How will you proceed with the assessment of A and how can the tax, if any, levied on him be recovered ? *(Agra M. Com. 1946)*

A is a non-resident, but his British Indian income liable to tax is Rs. 15,000— Rs. 10,000 from property (Rs. 12,000 rent minus one-sixth allowance for repairs) and Rs. 5,000 from interest. A's assessment may be made either in his own name or in the name of his agent through whom he has received the rent and interest.

The Income-Tax Officer must serve on the resident person a notice of his intention of treating such person as the agent of A, thus giving him an opportunity of being heard as to his liability.

The person treated as the agent of A for purposes of income-tax has a right to deduct from payments to A the amount of tax which he estimates he will have to pay over on A's British Indian income.

As A is a British non-resident, he will pay both income-tax and super-tax at the average rates of income-tax and super-tax applicable to his total world income.

When the tax payable by A has not been deducted at source or when there is no resident agent from whom it may be recovered, any arrears of tax can be recovered from any assets of the non-resident which are or may at any time come within British India. There is no time limit to such recovery.

Test Questions

1. Which income of a non-resident is liable to tax in British India ?

2. How is the amount of income-tax and super-tax payable by a non-resident calculated ?

3. Under what circumstances can a person be appointed as the agent of a non-resident principal ? In examining the accounts of a broker in British India a number of payments made to a New York broker on account of speculation profits are noticed. What steps, if any, would you take either to assess such profits or to recover from the payer the tax that in your view ought to have been deducted under section 18 (3A) ?

4. How will you determine the income-tax and super-tax liability in the following cases ?—

(a) A non-resident British subject with income both within and without British India ;

(b) A non-resident British subject with Indian income and foreign loss ;

(c) An individual with share in an unregistered firm assessed to income-tax only but not to super-tax.

CHAPTER 19.

ASSESSMENTS (I)

The I. T. O. is the assessor. He makes the assessment. The term assessment means the determination of *(i)* the total income of an assessee and *(b)* the amount of tax payable by, or refundable to, him. The assessment proceedings are initiated with the Return of Total Income to be filed by the assessee.

Return of Total Income. – Section 22 (1) requires an I. T. O. to publish general notices in the press calling upon every person within his jurisdiction to make a return of his total income exceeding Rs. 3,000 in the previous year. He is also to send an individual notice, under Section 22 (2) to every person whom he believes to have an income liable to assessment.

The return of total income is to be made in a prescribed form, a copy of which can be obtained from the Income-Tax Office.

If a person fails to furnish a return of total income within the time specified in the notice, he may furnish it at any time before the assessment is made. Should there be any error or omission in the return already submitted, the assessee may furnish a revised return at any time before the assessment is made.

Failure to furnish the return of income without reasonable cause involves a penalty which can be as much as one and half times the tax payable—to be paid in addition to the tax itself. But no penalty can be imposed on an assessee whose total income is less than Rs. 3,500 or upon the agent of a non-resident unless he has been served with an individual notice.

If a person has received an individual notice to make a return but refuses to do so, a penalty up to Rs. 25 can be imposed upon him if he proves that his total income is less than Rs. 3,000.

The Assessment

Section 23, under which assessments are made, contemplates three kinds of assessments :

1. Where the I. T. O. is satisfied that the return of income is correct and complete, he assesses the total income of the assessee and determines the amount of tax on the basis of such return.

2. Where the return of income is believed to be incomplete and the assessment is made after an enquiry, the next step to be taken by the I. T. O. is the service of a notice under section 23 (2) on the assessee requiring him on a date therein specified either to attend at the Income-tax Office or to produce any evidence in support of his return. If the I. T. O. wishes the assessee to attend personally he can insist on this by issuing an order under section 37.

Under section 22 (4) the I. T. O. can also call upon any person who has made a return to produce such accounts and documents as he may require, but the I. T. O. cannot call upon an assessee to produce books of account going back for a period of more than three years prior to the previous year on the profits of which the assessment is based.

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How will you proceed with the assessment of A and how can the tax, if any, levied on him be recovered ? *(Agra M. Com. 1946)*

A is a non-resident, but his British Indian income liable to tax is Rs. 15,000— Rs. 10,000 from property (Rs. 12,000 rent minus one-sixth allowance for repairs) and Rs. 5,000 from interest. A's assessment may be made either in his own name or in the name of his agent through whom he has received the rent and interest.

The Income-Tax Officer must serve on the resident person a notice of his intention of treating such person as the agent of A, thus giving him an opportunity of being heard as to his liability.

The person treated as the agent of A for purposes of income-tax has a right to deduct from payments to A the amount of tax which he estimates he will have to pay over on A's British Indian income.

As A is a British non-resident, he will pay both income-tax and super-tax at the average rates of income-tax and super-tax applicable to his total world income.

When the tax payable by A has not been deducted at source or when there is no resident agent from whom it may be recovered, any arrears of tax can be recovered from any assets of the non-resident which are or may at any time come within British India. There is no time limit to such recovery.

Test Questions

1. Which income of a non-resident is liable to tax in British India ?

2. How is the amount of income-tax and super-tax payable by a non-resident calculated ?

3. Under what circumstances can a person be appointed as the agent of a non-resident principal ? In examining the accounts of a broker in British India a number of payments made to a New York broker on account of speculation profits are noticed. What steps, if any, would you take either to assess such profits or to recover from the payer the tax that in your view ought to have been deducted under section 18 (3A) ?

4. How will you determine the income-tax and super-tax liability in the following cases ?—

(a) A non-resident British subject with income both within and without British India ;

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CHAPTER 19.

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The return of total income is to be made in a prescribed form, a copy of which can be obtained from the Income-Tax Office.

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Failure to furnish the return of income without reasonable cause involves a penalty which can be as much as one and half times the tax payable—to be paid in addition to the tax itself. But no penalty can be imposed on an assessee whose total income is less than Rs. 3,500 or upon the agent of a non-resident unless he has been served with an individual notice.

If a person has received an individual notice to make a return but refuses to do so, a penalty up to Rs. 25 can be imposed upon him if he proves that his total income is less than Rs. 3,000.

The Assessment

Section 23, under which assessments are made, contemplates three kinds of assessments :

1. Where the I. T. O. is satisfied that the return of income is correct and complete, he assesses the total income of the assessee and determines the amount of tax on the basis of such return.

2. Where the return of income is believed to be incomplete and the assessment is made after an enquiry, the next step to be taken by the I. T. O. is the service of a notice under section 23 (2) on the assessee requiring him on a date therein specified either to attend at the Income-tax Office or to produce any evidence in support of his return. If the I. T. O. wishes the assessee to attend personally he can insist on this by issuing an order under section 37.

Under section 22 (4) the I. T. O. can also call upon any person who has made a return to produce such accounts and documents as he may require, but the I. T. O. cannot call upon an assessee to produce books of account going back for a period of more than three years prior to the previous year on the profits of which the assessment is based.

In this way, when the I. T. O. has satisfied himself, he makes the assessment and determines the tax to be paid by the assessee.

3. Where there is a "best judgment assessment" (*i. e.*, an assessment made by the I. T. O. to the best of his judgment) which has to be made in three cases :

(a) Where the assessee has failed to make a return of income as required by a notice under section 22 (2) and has not made a return or a revised return under section 22 (3) :

(b) Where he has failed to comply with a notice for production of accounts under section 22 (4) ; or

(c) Where he has failed to comply with a notice for attendance or production of evidence under section 23 (2).

Assessees have now two remedies against the best judgment assessments: *(i)* a right to apply to the I. T. O. for the cancellation of assessment under section 27 and *(ii)* a right of appeal to the Appellate Assistant Commissioner under section 30.

When there is a best judgment assessment, the assessee may also be liable to a penalty amounting to $1\frac{1}{2}$ times the tax payable (in addition to the tax itself) ; but the penalty cannot be imposed by the I. T. O. without the previous sanction of the Inspecting Assistant Commissioner.

The right of appeal gives to the assessee a remedy where the I. T. O. has been grossly unfair ; and if an assessee year after year fails to send in a return of income or to furnish the information called for, he will be liable to a penalty unless his failure has been due to some reasonable cause.

In the case of the best judgment assessment, if the assessee is a firm, the I. T. O. is authorised to cancel its registration, or, if the firm has applied for registration, he may refuse to register it.

Notice of demand.—When an assessment on a person has been made the I. T. O. serves upon him, under section 29, a notice specifying the amount payable and the date by which the payment is to be made, and this notice is accompanied by a copy of the assessment.

Mode of recovery.—If there is default in paying the tax within the time prescribed, the I. T. O. is empowered by section 46 to levy a penalty ; and in case of continued default the penalty may be enhanced from time to time, but the total penalty should not exceed the amount of arrears. An appeal can be preferred from an order imposing a penalty under this section provided the tax in arrears is paid.

Arrears of tax can be recovered through the Collector as if they were arrears of land revenue ; and in case of salaries arrears of tax may be recovered by requiring the person paying salaries to deduct the arrears due from the salary of the employee.

No proceedings for recovery of arrears of tax or any sum payable under the Act shall be commenced after the expiry of *one* year from the last day of the financial year in which the demand is made.

Cancellation of assessment when cause is shown. Where an assessee, within one month from the service of a notice of demand, satisfies the I. T. O. that :—

(a) he is prevented by sufficient cause from making the return of income under section 22 (2) or section 34, or

(b) he did not receive the notice issued under section 22 (4) or section 23 (2), or by sufficient cause he was prevented from complying with the terms of these notices.

then the I. T. O. shall cancel the assessment and proceed to make a fresh assessment—section 27.

Income escaping assessment. Under section 34, if the I. T. O. has *definite* information that there has been complete escapement, under assessment, assessment at too low a rate or excessive relief, he has a right to re-open assessments for past years. In a case in which the I. T. O. has reason to believe that there has been concealment of income or the deliberate rendering of false returns, he can re-open assessments for *eight* years back, and in any other case for *four* years back. These drastic powers do not have retrospective effect, and for years prior to 1st April 1939 the time limit remains at one year.

In such cases the tax is to be charged at the rate at which it would have been charged if the income had not escaped assessment or full assessment.

In case of deliberate concealment of income, a penalty amounting to 1½ times the tax that would have been evaded can also be imposed.

Rectification of mistake. Under section 35 the Commissioner, the Appellate Assistant Commissioner or the I. T. O. may (whether on his own motion or the application of an assessee) rectify any mistake apparent from the facts or documents which were before him when he passed his revisional, appellate or original assessment order as the case may be.

The period of limitation for the rectification of mistakes is *four* years; but no such rectification shall be made of any mistake in any order passed more than a year before 1st April 1939.

This section does not confer on officers a general power of review or authorise any assessee to introduce any new facts in connection with the said assessment.

Orders of rectification which result in an enhancement of the assessment cannot be made without giving notice to the assessee and giving him an opportunity of being heard.

Assessment when there is change in constitution or succession.—Section 26 gives effect to the principal that the assessment on the profits of the previous year should be made on the person who received the profits.

Therefore when there is a change in the constitution of a firm or a firm has been newly constituted or when there has been a change in the proprietorship of a business, profession or vocation, the persons who are entitled to receive the profits are the persons to be assessed on them.

Provision is also made for assessment on and recovery of tax from the successor in the case where the predecessor cannot be found or where he will not or cannot pay the tax. An explicit right is also given to the person by whom tax properly payable by another is paid to recover any amount so paid from that other person.

Assessment of temporary residents. Under section 24-A, which is designed to bring temporary residents such as touring theatrical companies, etc., under assessment when it appears to an I. T. O. that a person may leave India during the current year or shortly after its expiry and may not return, the I. T O. may serve a notice upon him requiring to furnish a return of his total income for each of the completed previous years from the period from the exipiry of the last previous year for which he has been assessed, or where he has not been previously assessed, of his estimated total income for the period from the expiry of the last such completed previous year to the probable date of his departure. The minimum period within which such a return should be required to be made is seven days. Such a notice under 22 (2) and all the provisions relating to assessment apply thereafter.

The assessment shall be made for each completed previous year included in the period of assessment at the rate at which such total income would have been charged had it been fully assessed. As regards the period from the expiry of the last of such previous years to the probable date of departure the I. T. O. should estimate the total income and assess it at the rate in force for the year during which the assessment is made.

This section provides an exception to the general rule that assessments are made on the income of the previous year.

Assessment of a deceased person. Under section 24-B, an executor, administrat r or other legal representative of a deceased person is treated as the assessee for the purpose of assessment on the income of the deceased person. The liability of the executor, administrator or other legal representative is, however, confined to the payment of tax to the extent to which the estate is capable of meeting the charge.

Assessment in case of discontinued business. Business that may be discontinued fall in two classes; *(i)* thos that have never been taxed under the Income-Tax Act of 1918, and *(ii)* those that have at any time been taxed under the Income-Tax Act of 1918. The method of assessment in these two cases is different.

(i) Section 25, (1) and (2) makes the following provisions for the assessment of a discontinued business, profession or vocation which has never been taxed under the Income-Tax Act of 1918:—

(a) In order to guard against a possible loss of revenue owing to delay in making assessments on the profits of a business, profession or vocation that closes down during the course of a financial or commercial year, it is provided that in such cases, in addition to the assessment on the income of the previous year, a further assessment may be made in which it is closed down on the income of that year.

(b) Persons discontinuing a business, profession or vocation must give notice of such discontinuance within 15 days to the I. T. O. otherwise they become liable to a penalty.

(c) The power to make this additional assessment is a *discretionary* power which may be exercised whether the business is a purely temporary one commencing and closing down in the same year, or whether it is a business that has been in existence and has been previously taxed under the present Act. It should be used only in cases where there is reason to anticipate that the tax may not be collected unless the assessment is made in the year in which the business closes down.

(d) The profits to be taxed in this way are the profits accruing between the end of the last previous year (of which the profits have been taxed) and the date of discontinuance of the business. The rate to be applied in taxing a discontinued business is the rate in force in the year in which the assessment is made. This is another exception to the general rule that assessments are made on the income of the previous year.

(ii) Section 25 (3) deals with the discontinuance of a business, profession or vocation which has at any time been taxed under the Income-Tax Act of 1918, according to which Act a provisional assessment was made on the estimated income of the year and this assessment was subsequently adjusted and corrected when the income of the year in which the provisional assessment was made was ascertained.

This system was abolished by the Income-Tax Act of 1922, and to prevent double taxation for one year which would otherwise result, a discontinued business, profession or vocation (which has been taxed under the 1918 Act) is not liable to tax in respect of profits for the period from the end of the last previous year to the date of discontinuance. Moreover the assessee in such a case is entitled to substitute the profits of that period for the profits of the last previous year.

When a claim for this concession is made it must be supported by proof that tax had been charged under the Act of 1918 in respect of that very business. A claim to be assessed under this sub-section may be admitted if it is made not later than one year from the date on which the business is discontinued.

When there is a succession to a business, profession or vocation which has at any time been taxed under the Income-Tax Act of 1918, the owner of the business which is also entitled under section 25 (4) to the concession enjoyed by the owner of a discontinued business. It means that the predecessor in such a case is not liable to pay tax on the income of the period from the end of the previous year to the date of succession, and he can also claim that the income of that period shall be deemed to be the income of the previous year. No claim for relief in such cases shall be entertained unless it is made before the expiry of one year from the date of succession.

Illustrations

(a) If a profession (set up in 1916) whose previous year ended on 31st March is closed down on 31st March 1940, its assessment for 1939-40 would be on the profits of 1938-39, or at its option on the profits of 1939-40 and no assessment will be made for 1940-41.

(b) If this profession closed down on 30th April 1939 (instead of on 31st March 1940), it would still be assessed in the year in which it closed down (1939-40), but the assessment would be on the profits of 1938-39, or at its option on the profits of only April 1939, and no assessment would be made for the year 1940-41.

(c) A business started before 1918 whose accounting year ended on 30th April is closed down on 30th September 1939. Then its assessment in the financial year 1940-41 would be on the profits of the previous year to 30th April 1939, or at its option on its profits from 1st May 1939 to 30th September 1939, and no assessment would be made for the financial year 1941-42.

Appeals. When an assessee is not satisfied with the I. T. O.'s order, he has a right of appeal. The procedure of appeals is explained in Chapter 23.

Penalties.—The penalty provisions of the Act are contained in the following sections :—

1. *Section 25 (2)*—When any business, profession or vocation on which tax was not any time charged under the Indian Income-Tax Act of 1918 is discontinued in any year, the proprietor must give notice of such discontinuance to the I. T. O. within 15 days thereof. On default the I. T. O. may impose a penalty not exceeding the amount of tax subsequently assessed in respect of the profits of such business up to the date of its discontinuance.

2. *Section 28.*—Under this section the I. T. O. (with the previous approval of the Inspecting Assistant Commissioner), the Appellate Assistant Commissioner or the Commissioner, may impose penalties on the assessees on the following grounds :—

(a) If the assessee has without reasonable cause failed to furnish a return under section 22 (1) or (2) or section 34, or has not filed it within the prescribed time or in the prescribed manner,

(b) If he has without reasonable cause failed to employ with a notice for production of accounts under section 22 (4) or for attendance or production of evidence under section 23 (2), or

(c) If he has concealed particulars of his income.

Note.—No penalty can be imposed for failure to furnish the return of income on an assessee when his total income is less than Rs. 3,500 or on the agent of a non-resident unless an individual notice has been served upon him under section 22 (2).

In the case of failure to furnish a proper return the maximum penalty that can be inflicted is 1½ times the tax payable by the assessee ; in other cases the maximum amount of the penalty is 1½ times the amount of tax which would have been avoided if the income returned had been accepted as correct.

If a person has received an individual notice to make a return but refuses to do so, a penalty up to Rs. 25 can be imposed upon him if he proves that his total income is less than the taxable minimum.

If the profits of a registered firm are improperly distributed so as to return the income of any partner below the real amount, and if any partner of a registered firm returns his income below the real amount, a penalty of 1½ times the amount of tax which would have been avoided if his return had been accepted as correct may be imposed and no refund or other adjustment can be claimed by any other partner by reason of this procedure.

3. *Sections 44-E and 44-F.*—Very heavy penalties are imposed for failure to comply with the I. T. O.'s demands for information in respect of certain artificial transactions in securities (known as bond washing) carried out by assessee with a view to avoidance of tax. In such a case the penalty can be as much as Rs. 500 per day so long as the default continues.

4. *Section 46 (1)*—When there is a default in paying the tax within the time fixed, I. T. O. may impose a penalty which may be enhanced from time to time, but the total penalty should not exceed the amount of arrears.

5. *Section 51.*—If a person fails without reasonable cause

(a) to deduct and pay any tax as required by section 18 or under section 46 (5) ;

(b) to furnish a certificate required by section 18 (9) or section 20 to be furnished ;

(c) to furnish in due time any of the returns mentioned in section 19 A section 20A, section 21, Section 22 (2) or section 38 ;

(d) to produce or cause to be produced on or before the date mentioned in any notice under section 22 (4) such accounts and documents as are referred to in the notice ,

(e) to grant inspection or allow copies to be taken in accordance with the provisions of section 39,

he shall, on conviction before a magistrate, be punishable with fine which may extend to Rs. 10 for every day during which the default continues.

6. *Section 52.*—If a person knowingly makes a false declaration in any document filed under the Act, he shall be punishable, on conviction before a magistrate, with simple imprisonment which may extend to six months or with fine which may extend to Rs. 1,000 or with both.

N. B.—A person shall not be proceeded against for an offence under section 51 or section 52 except at the instance of the Inspecting - Assistant Commissioner. This Inspecting Assistant Commissioner may either before or after the institution of proceedings compound any such offence.

Test Questions

1. Section 22 (1) of the Indian Income-Tax Act lays down that each year the Income-Tax Officer shall give a public notice requiring every person, whose total income during the previous year exceeded the maximum amount which is not chargeable to tax, to furnish within the specified time a return of his total income and total world income during that year.

After the above notice, is it also necessary that the Income-Tax Officer should send an individual notice to each assessee, and, if so, what is the advantage of giving public notice ?

Is a person whose income exceeds the maximum amount which is not chargeable to tax, liable to any penalty (i) if he does not comply with the public notice ; and (ii) if he does not comply with the individual notice too ?

Is there any penalty it a person, whose income is below the maximum amount which is not chargeable to tax, does not comply with the individual notice ? *(Agra B. Com. 1946)*

2. Describe, step by step, how you will prepare the assessment of an ordinarily resident individual.

3. Point out the disadvantages and the penalties to which tax-payers expose themselves by making the following defaults :—

(a) Failure to file the return of income ;

(b) Failure to produce the accounts or other documents called for by the Income-Tax Officer to verify the correctness of the return of income,

(c) Maintaining incomplete accounts without employing any regular method of accounting so that income, profits and gains cannot properly be deduced therefrom ;

(d) Concealing the income ;

(e) Failure to pay the amount of tax. *(Agra M. Com. 1945)*

4. Explain fully the relevant provisions of the Indian Income-Tax Act under which no tax is payable in respect of the profits and gains of a business, profession or vocation in the event of its discontinuance, and a claim for the refund of tax already paid may also be made in some cases.

Why, in your opinion, has this special provision been made ? How far does this concession apply to super-tax ? *(Agra M. Com. 1946)*

5. In what circumstances may an assessment be cancelled ?

6. What are the provisions of law regarding income that has escaped assessment ?

7. State the procedure of the Income-Tax Department for the taxation of an individual. State also the consequences of failure of the part of the assessee to submit returns. *(Agra M. Com. 1948)*

8. What do you understand by 'Best Judgment Assessment' ? When does such assessment arise ? What observations would you like to make considering the problem involved ? Indicate to your client the correct legal procedure so that such an assessment may not take place. *(Agra M. Com. 1948)*

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CHAPTER 20

ASSESSMENTS (2)

How to Prepare the Assessment

(a) Residents.

In preparing the assessment of a resident, the following four successive steps have to be taken :—

I. Compute the total income as explained in Chapter 13. Add up the various amounts of tax already deducted or otherwise paid at source. Then ascertain the taxable income by deducting from the total income the amount of earned income allowance, if any.

II. Calculate the amount of income-tax on the taxable income minus the capital gains at the rates mentioned in the Indian Finance Act and also calculate the income-tax on the capital gains at the rates mentioned in Chapter 8, and add the two amounts together, thus ascertaining the total amount of income-tax chargeable on the total income. Then work out the average of income-tax in pies per rupee to two decimal places.

Calculate super-tax on the total income minus the capital gains, and work out the average rate of super-tax in pies per rupee to two decimal places, if necessary; and this will be necessary only in the case of an ordinary resident who has any unremitted Indian State income. Where the total income consists of partly earned income and partly unearned income, the super-tax on the total income will be the total of the following amounts :—

(a) Super-tax on the earned income proportionate to the super-tax on the total income assuming the total income to be wholly earned *and*

(b) Super-tax on the unearned income proportionate to the super-tax on the total income assuming the total income to be wholly unearned.

III. Ascertain the amount of income exempt from income-tax and/or super-tax, and calculate the amount of income-tax or super-tax relief thereon at the average rate of income-tax and super-tax.

IV. From the gross amount of income-tax and super-tax as computed in the second step above *deduct*.

(a) the amount of tax already collected at source ;
(b) the amount of relief on exempted income ; and
(c) the amount of double taxation relief (if any) in respect of foreign income.

The balance will then be the net amount of tax payable or refundable. Finally add the amount of penalty, if any, imposed upon the assessee, and thus arrive at the total sum payable or refundable.

(b) Non-residents.

Compute the total income and the total world income as explained in Chapter 13; add up the various amounts of tax already deducted or otherwise paid at source; and ascertain the taxable income by deducting from the

total income the amount of earned income allowance, if any. Then find out whether the assessee is a British non-resident or a non-British non-resident.

A British non-resident is not liable to pay tax if his total world income does not exceed Rs. 3,000.

In the case of British non-residents, calculate the gross amount of income tax on the total world income as reduced by the earned income allowance and capital gains, if any, and calculate income-tax on the capital gains. The total of these two amounts will be the gross income-tax on the total world income. Then find out the average rate of income tax in pies per rupee to two decimal places. Calculate also the super-tax on the total world income as reduced by capital gains (if any), *as if it were the total income*, bearing in mind the differentiation between the earned and unearned income for super-tax purposes. Work out the average rate of super-tax in pies per rupee to two decimal places.

Then compute the gross amount of income tax chargeable on the total income minus the earned income allowance and the capital gains at the average rate of income-tax as calculated above and add to it the income-tax calculated on the capital gains. Also find out the gross amount of super-tax chargeable on the total income minus the capital gains at the average rate of super-tax as calculated above.

In the case of non-British non-residents (who are liable to pay tax whatever the amount of their total income may be), ascertain the gross amount of income-tax on the total income minus the earned income allowance and the capital gains at the maximum rate of income-tax, adding thereto the income-tax on the capital gains. The gross amount of super-tax will be calculated in the same way as in the case of British non-residents.

Then proceed in the same way as for residents until you get the total sum payable or refundable.

Illustrations

1. Take the illustration given in Chapter 13, and then prepare the assessment (a) when the assessee is resident ordinarily resident, and (b) when the assessee is a resident not ordinarily resident.

Assessment for 1947-48

(a) When the assessee is a resident ordinarily resident.

	Income or Loss Rs.	Tax already collected Rs. a. p.
I. Total income (as computed in Chapter 13)	77,500	1,243 12 0
Less Earned income allowance on salary	2,300	
Taxable Income	75,200	
II. Gross amount of income-tax chargeable on Rs. 55,200 (Rs. 75,200—Rs. 20,000 capital gains)		14,500 0 0
Gross amount of super-tax chargeable Rs. 20,000 capital gains ...		1,250 0 0
		15,750 0 0

(Average rate of income-tax 40·21 pies)		
Gross amount of super-tax chargeable on Rs, 57,500 (i. e., Rs. 77,500 — Rs. 20,000 capital gains) as explained in a note below ...		8,187 8 0
(Average rate of super-tax 27·34 pies,		
Total gross tax		23,937 8 0
III. Income exempt from income-tax :		
Tax-free interest on securities	500	
Life insurance premiums	6,000	
Shares of profits from an unregistered firm	5,000	
Indian State income	12,000	
	23,500	
Income exempt from super-tax :		
Indian State income	12,000	
Amount of income-tax relief ...		4,921 8 0
Amount of super-tax relief ...		1,708 12 0
		6,630 4 0
IV. Gross amount of tax chargeable on total income		23,937 8 0
Less Tax already collected at source	1,243 12 0	
Relief on exempted income	6,630 4 0	
Double Taxation relief (ignored)	—	7,874 0 0
		16,063 8 0
Add Penalty if any		Nil
Amount of tax payable	Rs.	16,063 8 0

Notes

1. The amount of tax collected at source is arrived at as follows :—

(a) From salary	743 12 0
(b) From interest on securities	312 8 0
(c) From dividends	187 8 0
	1,243 12 0

2. As the total income includes income from salary, interest on securities and dividends amounting in all to Rs. 13,600 (from which tax has been collected at source), the amount of income-tax thereon will be proportionate to the amount of income-tax on the total income of Rs. 55,200 at the rates of income-tax in force in the assessment year 1946-47 i. e., the year in which the tax was actually collected ; but the income-tax on the rest of the income namely, Rs. 41,600 will be proportionate to the amount of income tax on the total income of Rs, 55,200 at the rate of income-tax in force in the assessment year 1947-48 but as the rates of income-tax in both these assessment years are the same, this provision does not affect the calculation of gross income-tax.

3. The super-tax on the total income, which consist partly of earned income and partly of unearned income; has been computed as follows :—

(a) The super-tax on the earned income of Rs. 11,500 will be proportionate to the super-tax on the total income Rs. 57,500 assuming it to be wholly earned viz.—

On Rs. 25,000		Nil		
On Rs. 5,000 at 2 annas per rupee		625	0	0
On Rs. 5,000 at 2½ annas per rupee		781	4	0
On Rs. 10,000 at 3 annas per rupee		1,875	0	0
On Rs. 10,000 at 4 annas per rupee		2,500	0	0
On Rs. 2,500 at 5 annas per rupee		781	4	0
On Rs. 57,500	Rs.	6,562	8	0

Therefore the proportionate amount of super-tax on Rs. 11,500 will be Rs. 1,312-8 0.

(b) The super-tax on the unearned income of Rs. 46,000 will be proportionate to the super-tax on the total income of Rs. 57,500 assuming it to be wholly unearned, viz.

On Rs. 25,000		Nil		
On Rs. 5,000 at 3 annas per rupee		937	8	0
On Rs. 5,000 at 3½ annas per rupee		1,093	12	0
On Rs. 10,000 at 4 annas per rupee		2,500	0	0
On Rs, 10,000 at 5 annas per rupee		3,125	0	0
On Rs. 2,500 at 6 annas per rupee		937	8	0
On Rs. 57,500	Rs.	8,593	12	0

Therefore the proportionate amount of super-tax on Rs. 46,000 will be Rs. 6,875.

Hence the, total amount of super-tax on Rs. 57,500 will be Rs. 8,187-8-0

(b) When the assessee is a resident not ordinarily resident.

	Income or Loss Rs.	Tax already collected Rs. a. p.
I. Total income (as computed in Chapter 13)	63,500	1,243 12 0
Less Earned income allowance on salary	2,300	
	61,200	
II. Gross amount of income tax chargeable on Rs. 41,200 (Rs. 61,200–Rs. 20,000 capital gains) ...		10,125 0 0
Gross amount of income-tax chargeable on Rs. 20,000 capital gains ...		1,250 0 0
		11,375 0 0
(Average rate of income-tax 34·05 pies)		
Gross amount of super-tax chargeable on Rs. 43,500 (i. e., Rs. 63,500–Rs. 20,000 capital gains)		3,850 9 0
Total gross tax		15,225 9 0

III. Income exempt from income-tax :					
Tax-free interest on securities	500				
Life insurance premiums	6,000				
Shares of profits from an unregistered firm	5,000				
	11,500				
Amount of income-tax relief			2,039	7	0
IV. Gross amount of tax chargeable on total income			15,225	9	0
Less Tax already collected at source	1,243 12 0				
Relief on exempted income	2,039 7 0				
Double Taxation relief (ignored)	—		3,283	3	0
			11,942	6	0
Add Penalty, if any			Nil		
Amount of tax payable Rs.			11,942	6	0

2. S, a retired employee of the Government of India and an ordinary resident, makes a return of his income of the year ended 31st March 1947 showing the following incomes :—

	Rs.	Rs.
Interest on tax-free government securities		5,000
Less Bank collecting commission	25	
Interest paid to a bank with which the securities are mortgaged for a loan taken for purchasing the securities	3,500	
Brokerage paid for securing the above loan ...	175	3,700
		1,300
Dividend received in British India from a company in an Indian State, earning its entire income in that state, but 50% of income was derived from agriculture		2,700
Pension at Rs. 100 p. m. for 8 months ... (It is explained that the balance of the pension was received by him in Ceylon where he had gone for a change, the Government of India having agreed to send the pension to him there. It is claimed that since the pension was payable without India, it is exempt).		800

The life insurance premium paid by him is Rs. 1,000 on an endowment policy on his own life, the capital sum assured being Rs. 5,000.

It was learnt on enquiry that the assessee is a partner in a registered firm and that his share of income in that firm during the firm's trading year ended 31st October 1946 was Rs. 8,000. The assessee's wife is also a member of that firm, her share of income during the same year being Rs. 4,000 only, but she had already made a return of her own income separately.

The assessee owns a house property used as his residence, the annual letting value of which is Rs. 2,400.

(a) Compute the assessee's total income.

(b) What is the amount of life insurance premium on which the assessee is entitled to relief ?

(c) Indicate (without actual calculations) how the income-tax and super-tax are to be calculated. *(Income-Tax Departmental Exam. 1945)*

Total Income for the assessment year 1947-48.

			Rs.
1.	Salary (Pension from Govt, of India)		1,200
2.	Interest on tax-free government securities (after deducting Rs. 25 for bank commission and Rs. 3,500 for interest on borrowed money)		1,475
3.	Property income :		
	Annual value restricted to 10% of total income ...	1,895	
	Less one-sixth for repairs ...	315	1,580
4.	Business : Registered firm's share *including his wife's share* ...		12,000
5.	Other sources : Dividends ...		2,700
	Total Income		18,955
	Less Earned income allowance (being one-fifth of Rs. 13,200) assuming that both S and his wife were active partners in the firm. ...		2,640
	Taxable Income		16,315

The amount of life insurance premium on which the assessee is entitled to relief is Rs. 500.

The income-tax payable by the assessee will be calculated as follows :—

(a) The amount of income-tax on salary and interest on securities will be proportionate to the income tax on the assessable income at the rates applicable in the assessment year 1946–47 ;

Test Questions

1. In the examples A and B below are shown the incomes earned by two persons during the year ended 31st March 1946. In each case show in the appropriate place against each source of income :

(i) the amount of earned income allowance.

(ii) the rate of income-tax not in figures but expressed as 'the rate applicable to a total income of Rs......... under the Finance Act' 1945 or 1946 as the case may be.

(iii) the rate of super-tax expressed as above.

	Source of Income	Amount
A.	Salary	Rs. 28,000
	Business	36,000
	Interest on securities	12,000
B.	Salary	Rs. 12,000
	Profession	6,000
	Dividend	10,000

(Income-Tax Departmental Exam. 1946)

2. *Profit and Loss Account*

	Rs.		Rs.
To Salaries and wages ...	6,200	By Gross Profit ...	56,000
" Rent and Taxes ...	4,000	" Divident on shares (less tax)	1,595
" Trade Expenses ...	2,000	" Profit on re-issue of forfeited shares	1,000
" Directors' fees ...	1,000	" Unclaimed dividend written back	900
" Auditors' fees ...	1,000	" Miscelleneous receipts ...	300
" Legal charges ...	500		
" Charity	101		
" Fire Insurance Premium ...	600		
" Travelling Expenses ...	1,600		
" Bad Debts	1,200		
" Reserve for Doubtful Debts...	2,000		
" Loss on issue of Debentures written off	2,000		
" Loss on sale of furniture ...	300		
" Annual pension to the retired manager	1,500		
" Net profit	35,794		
Total ...	59,795	Total ...	59,795

From the above Profit and Loss Account of the Malabar Trading Co., Ltd., for the year ended 30th September, 1946, find out the income-tax and super-tax payable. *(Agra M. Com. 1948)*

3. The following are particulars about the income of Mr. X of Allahabad University :—

(a) He was employed on 1st July 1945 in the grade of Rs. 500–30–800 plus dearness allowance at 10% of the salary.

(b) He contributes 8% of the salary to his Provident Fund, while the University contributes 12%.

(c) As Proctor of the University he received—

(i) an allowance of Rs. 100 per month ;
(ii) a rent-free bungalow of the annual municipal valuation of Rs. 540 ;
(iii) an orderly who is paid Rs. 35 per month by the University ;
(iv) a motor-car allowance of Rs. 45 per month.

(d) His income from examinership amounted to Rs, 1,150 and from royalty to Rs. 750

(e) He holds 50 shares of Rs. 100 each in the Upper India Trading Co., Ltd., on which he received a dividend of 12% less tax.

(g) He received a prize of Rs. 350 in a 'Commonsense Crossword' competition.
He paid Rs. 1,520 as premium on his life insurance policy.

You are required to prepare his assessment for the year 1947–48. The actual amount of tax payable by him need not be calculated. *(Agra B. Com. 1948)*

. Raja Ram and Din Dayal are partners in a registered firm sharing profits and losses in the proportion of two-thirds and one-third, respectively. Their Profit and Loss Account for the year ended on 31st December, 1946, was as follows :—

		Rs.			Rs.
To Sundry Expenses	...	22,800	By Profit on sale of goods	...	55 600
„ Charity	...	570	„ Commission received	...	620
„ Reserve for Bad Debts	...	1,430			
„ Legal Charges	...	860			
„ Interest on Capital :—					
Raja Ram	...	1,280			
Din Dayal	...	750			
Profit :—					
Raja Ram	...	19,020			
Din Dayal	...	9,510			
Total	...	56,220	Total	...	56,220

The item of Sundry Expenses includes salary of Raja Ram Rs. 1,800, and that of Din Dayal Rs. 1,200. It also includes Rs. 1,500, in respect of the rent of the residential house of the two partners. The house is shared by the two partners—half and half—according to terms of agreement. Legal charges were incurred in recovering the amount due from a customer. Depreciation on Plant and Machinery, which is calculated at Rs. 3,340, and accrued interest on loan which amounts to Rs. 1,060, have not been provided for in the Profit and Loss Account above.

The other taxable income of the two partners is as follows :—

		Raja Ram Rs.	*Din Dayal* Rs.
Interest on Securities	...	400	2,100
Income from Property	...	600	...
Foreign income of which only Rs. 2,000 is remitted	...	...	7,700
Interest on Post Office Savings Bank Account	...	27	...
		1,027	9,800

You are required to calculate the taxable income of the firm and to prepare the assessments of Raja Ram and Din Dayal. The amount of tax payable by the two partners need not be calculated. *(Agra B. Com. 1948)*

CHAPTER 21

REFUND OF TAX

Refunds are necessitated generally by the system of "taxation at source" as in the case of dividends, and "deduction at source" as in the case of interest on securities, salaries and certain other payments. In both these groups of cases the average rate of tax, if any, appropriate to the "total income" or the "total world income" (as the case may be) of the recipient of the income is not known at the time the tax is assessed or deducted.

Section 18 (9) makes it obligatory upon the person deducting income-tax or super-tax to issue a certificate specifying the amount of the tax deducted from the income concerned and the rate at which it has been deducted; and similarly section 20 requires the principal officer of a company distributing dividends to issue to shareholders a certificate stating that the company has paid or will pay income-tax on the profits that are being distributed. These certificates are ordinarily accepted by Income-Tax Officers as proof that tax has been paid. For purposes of refund, dividends are deemed to have been taxed at the maximum rate of income-tax in force on the date on which they were paid, credited or distributed.

Section 48 provides that when the tax paid (including super-tax) exceeds the amount chargeable, the owner of the income is entitled to a refund of excess. Below are given examples of cases in which a right to claim a refund of tax may arise :—

1. Where the amount of tax collected at source is greater than the amount of tax properly payable.

2. Where the rectification of a mistake in the assessment under section 35 has the effect of reducing the tax paid.

3. Where an appeal against the assessment made by an I. T. O. results in a reduction of tax and the tax has already been paid.

4. Where a business, profession or vocation (which was charged to tax at any time under the Income-Tax Act of 1918) is discontinued or succeeded by another person (vide Chapter XVI).

Refund Procedure. An application for refund must be made, in the prescribed form to the I. T. O. concerned (or to the Income-tax Officer, Non residents Refund Circle Bombay, in the case of non-residents); and it must be accompanied by a return of total income or total world income (unless such a return has previously been made) and also by certificates relating to deduction of tax at source and taxation of dividends.

The onus of proving the claim to refund (and therefore of adducing satisfactory evidence of his total income and of total world income) lies on the claimant, and if he fails to discharge it his claim will be rejected.

Period of limitation. The time limit for refund claims is *four* years from the end of the assessment year (that is to say four years from the last day of the financial year commencing next after the expiry of the previous year in which the income arose or was brought into British India); but claims in respect of tax paid prior to 1st April 1939 will not be admissible unless

made within 12 months from the last day of the calendar year in which the tax was recovered or before the last day of the financial year commencing after the expiry of the previous year in which the income arose on which the tax was recovered whichever period may expire later.

Other provisions relating to refunds. (1) Where the income of one person is included in the total income of any other person, such other person only is entitled to a refund in respect of such income.

(2) The amount of refund instead of being paid may be set off against any tax remaining payable.

(3) Where through death, incapacity, insolvency, liquidation or other cause, a person cannot claim a refund, his legal representative can do so on his behalf.

(4) The necessity for making a claim for the refund of tax on interest on government securities (and also in respect of the tax on salaries, other interest and other sums paid to non-residents) can in many cases be avoided by obtaining a certificate from the I. T. O. to the effect that the total income or total world income of the recipient is not liable to tax or is liable only at a rate less than the maximum rate.

(5) A person objecting to an order of an I. T. O. refusing to allow a refund or granting a refund of an amount less than what he has claimed, has the right of appeal against such order.

Test Questions

1. Why are refunds of tax necessitated ? State a few cases in which a refund of tax may be claimed.
2. What is the procedure if you wish to claim a refund of tax ?
3. When does a claim to a refund of tax become time-barred ?

CHAPTER 22.

TAXATION OF INSURANCE COMPANIES

The taxable income of an insurance business is not computed in accordance with the provisions of section 10, but in accordance with the rules contained in the Schedule to the Income-Tax Act. In the words of Mr. S. P. Chambers "These rules are very complicated. They must of necessity be complicated because insurance is a complicated subject, and so is income-tax, and if you marry two complicated subjects you get something still more complicated."

A. **Life Insurance business.** The taxable income of a life insurance business (whether carried on by a proprietary insurance company or by a mutual insurance association) is taken to be either of the following two amounts *whichever is greater* :—

(a) The gross external incomings of the preceding year *less* management expenses of the preceding year, and

(b) The adjusted annual average actuarial surplus of the last *intervaluation* period ending before the assessment year, arrived at by adjusting the surplus or deficit.

(a) **Gross external earnings basis**—In computing the taxable income by this method the following provisions must be taken into account :—

1. "Gross external incomings" means all earnings from interest, dividends, fines and fees, etc., from whatever source derived (except premiums, interest and dividends on any annuity fund and profits on the sale of investments or other assets) provided that any income from property should be computed in accordance with the provisions of section 9.

2. "Preceding year" means that year for which annual accounts are required to be prepared under the Insurance Act of 1938, immediately preceding the year for which the assessment is to be made.

3. "Management expenses" means the full amount of expenses (including commissions) incurred exclusively for life insurance business, and, in the case of a composite company, a fair proportion of the general business expenses as well.

Bonuses to policyholder, depreciation of and losses on the sale of securities or other assets and any other expenditure which cannot be allowed as business expenditure under section 10 are *not* management expenses. Moreover, the amount of allowable management expenses is subject to the following maximum :—

Kinds of Policies	Percentage of first year's premiums	Percentage of renewal premiums
1. For single premium Policies ...	$7\frac{1}{2}$	—
2 For policies for which the number of annual premiums is less than 12	$7\frac{1}{2}$ times the number of such annual premiums	12
3. For policies for which the number of years during which premiums are payable is less than 12 ...	$7\frac{1}{2}$ times the number of such years	21
4. For all other policies ...	90	12

(b) **Actuarial surplus basis**—In computing the assessable income by this method the actuarial surplus should be subjected to the following adjustments ,—

1. The deficit or unappropriated surplus of any period preceding the intervaluation period consideration should be excluded.

2. Any expenditure which cannot be allowed under section 10 should be disallowed.

3. One-half of the amount paid to or reserved for or expended on behalf of *policy holders* should be allowed as a deduction, provided.

(i) That in the first computation made after 1st April 1939, in allowing one-half of the bonuses to policyholders no account should be taken of bonuses declared out of the unappropriated surplus of a previous inter-valuation period; and

(ii) That if any amount of the bonus reserved for policyholders ceases to be so reserved and is not paid to them, then one half of such amount, *if it has previously been allowed* as a *deduction, should be* treated as part of the surplus for the period in which it ceases to be so reserved.

4. Depreciation of or loss on realisation of securities or other assets and appreciation of or profit on realisation of securities or other assets should be taken into account. But if upon investigation it appears to the I. T. O. after consultation with The Superintendent of Insurance that the rate of interest or other factors employed in determining the liability in respect of outstanding policies is materially inconsistent with the valuation of securities and other assets so as artificially to reduce the surplus, the I. T. O. can adjust the allowance for depreciation of securities accordingly.

5. The amount *of* tax-free interest *from* Government securities *is not* to be excluded from the surplus of the inter-valuation period ; but the whole amount of such interest received during the intervaluation period shall be exempt from income-tax but not from super-tax.

Note. If the inter-valuation period exceeds twelve months, then credit should be given (against the gross tax computed on the annual average adjusted surplus) for the amount of the annual average tax deducted at source from interest on securities or otherwise paid during the said intervaluation period.

B. Non-life insurance business.— The taxable income of a non-life insurance business is computed from the profits as disclosed in the annual accounts after making the following adjustments :—

1. Expenses not admissible under section 10 should be disallowed.

2. Profits and losses on a realisation of investments and depreciation and appreciation of the value of investments are to be taken into account.

3. Any excess over the reasonable amount of reserve for unexpired risks should be regarded as income.

C. Dividing society or assessment insurance business.—The taxable income of companies transacting such business is taken at 15 per cent. of the premium income in the previous year.

D. British Indian branches of non-resident insurance companies.—The taxable income of the British Indian branches of non-resident insurance companies

doing life and non-life insurance business in British India is taken to be the proportion of the total world income corresponding to the proportion which its British Indian premium income bears to its total premium income, the total world income being computed in the same manner as the total income of a resident insurance company as explained in this chapter.

Test Questions

1. The Indian Income-Tax Act has made special provisions for the computation of the profits and gains of the insurance business. Explain these provisions fully, pointing out the difference between the assessment of the profits of life insurance business and other forms of insurance.

(Agra M. Com. 1946)

2. Explain : Actuarial Surplus ; Gross External Incomings ; Bonus.

CHAPTER 23

MISCELLANEOUS

1. Appeals

Appellate authorities.—1. In the first instance, the assessee can appeal, against the orders of the I. T. O., to the Appellate Assistant Commissioner.

2. If he is dissatisfied with the Appellate Assistant Commissioner's decisi-n, he can appeal to the Appellate Tribunal; but this second appeal is not given free of cost, as the notice of appeal must be accompanied by a fee of Rs. 100.

The right of appeal is given not only to the assessee; but also to the Income-Tax Department. The Commissioner of Income tax may direct an I. T. O. to appeal to the Appellate Tribunal against any order passed by the Appellate Assistant Commissioner. As stated in Chapter I, the Appellate Assistant Commissioner is under the direct control of the Central Board of Revenue, and not under that of the Commissioner of Income-tax.

This right given to the Income-tax Department to appeal should give the Appellate Assistant Commissioner confidence to decide appeals justly and boldly whether the decision is in favour of the assessee or against him, since he has full knowledge that both parties have an equal right of appeal to the Appellate Tribunal.

3, On any question of law either the assessee or the Commissioner may require the Appellate Tribunal to make a reference to the High Court. For such a reference the assessee must also pay Rs. 100.

An appeal shall lie to His Majesty in Council from any judgment of the High Court delivered on a reference made in any case which the High Court certifies to be a fit one for appeal of His Majesty in Council.

What can be appealed against.—It is an established rule of law that there is no inherent right of appeal and that a right of appeal must be given by a statute. By virtue of section 30, an appeal may be preferred against the following:

1. The amount of income assessed or the amount of tax determined under section 23 or 27.
2. Order under section 23-A *re* non-distribution of company profits.
3. The amount of loss computed under section 24.
4. Order under section 25 (2) *re* discontinuance of business.
5. Order under section 25-A repartition of a Hindu undivided family.
6. Order under section 26 (2) reassessment when there is a change of proprietorship of business.
7. A refusal of an I. T. O. to register a firm under section 26-A.
8. A refusal of an I. T. O, to make a fresh assessment under section 27.
9. Order under section 28 *re* imposition of penalty.
10. Order under section 44-E (6), 44-F (5) imposing a penalty for failure to furnish information called for.
11. Order under section 46 (1) imposing a penalty for non-payment of tax.
12. A refusal of an I. T. O. to allow a refund under section 48, 49 or 49-F.
13. The amount of the refund allowed by the I. T. O. under section 48, 49 or 49-F.

No appeal can lie against an order under section 46 (1) unless the tax has been paid; and where the partners of a firm are individually assessable on their shares in the total income of the firm, any such partner may appeal against the order of the I. T. O. determining the amount of the total income or loss of the firm or the apportionment thereof between the several partners.

Period of Limitation—The appeal should ordinarily be presented within thirty days of the receipt of the notice of demand or the intimation of order. The word 'ordinarily' implies that the Appellate Assistant Commissioner has power to extend the period. The latter half of section 30 (2) expressly empowers the Appellate Assistant Commissioner to admit an appeal after the expiration of the period of thirty days if he is satisfied that the appellant had sufficient cause for not presenting it within that period.

Form of appeal—The appeal should be in the prescribed form and verified in the prescribed manner. Various forms of appeals have been prescribed in the Rules.

2. Information at source.

The following are the provisions of law regarding the supply of information to the Income-tax Department :—

1. Under section 19-A, the principal officer of every company (which is an Indian company or a company which has made such effective arrangements as may be prescribed for the deduction of super-tax from such dividends) must file with the I. T. O., before 15th June each year, a return giving the names and addresses of those shareholders to whom dividends exceeding Rs. 5,000 were distributed during the preceding year, together with the amount paid to each.

2. Under section 20-A every person responsible for paying any interest (not being interest on securities) must furnish to the I. T. O., before 15th June each year, a return showing the names and addresses of those persons to whom interest exceeding Rs. 400 was paid during the previous financial year, together with the amount paid to each.

3. Under section 21, every employer must file with the I. T. O., before 30th April each year, a return of all employees deriving an income from salaries of Rs. 1,600 per annum or over.

4. Under section 25 (2), any person discontinuing a business, profession or vocation must give to the I. T. O., notice of such discontinuance within fifteen days of the discontinuance.

5. Under section 38, the I. T. O , or Assistant Commissioner (Appellate or Inspecting) may require (a) a firm to furnish the names and addresses of its partners ; (b) a Hindu undivided family to furnish the names and addresses of its manager and adult members ; (c) a trustee, guardian or agent to furnish the names and addresses of the persons for whom he is trustee, guardian or agent ; and (d) any assessee to furnish the names and addresses of those to whom he has paid in any year rent, interest, commission, royalty, brokerage or annuity amounting to more than Rs. 400, together with particulars of the amounts paid.

6. Under section 44-E (6) and 44-F (5) on a notice being received from the I. T. O., the owner of share and securities which have been temporarily transferred to another person must furnish the information called for.

7. Any dealer, broker or agent or any person concerned in the management of a stock or commodity exchange shall furnish a statement of the names and addresses of all persons to whom he or the exchange has paid any sum in connection with the sale, exchange or transfer of a capital asset or on whose behalf or for whom he or the exchange has received any such sum together with particulars of all such payments and receipts.

3. Representation of Assessees.

Under section 61, apart from lawyers, accountants who are registered or members of a recognised association, officers of a scheduled bank, relative or employees of the assessee, and persons who have acted as income-tax practitioners prior to 1st April 1939, nobody can represent the assessee in income-tax proceedings, unless he has passed a recognised accountancy examination or has acquired an educational qualification recognised by the Central Board of Revenue, which has already published a list of recognised accountancy examinations. This list includes, inter alia, the B. Com. Examination with Advanced Accountancy of any university in India.

Persons dismissed from government service after 1st April 1938 and persons found guilty of misconduct by their professional bodies (in the case of lawyers and accountants) and by the Commissioner in other cases, are debarred from representing assessees. The direction of the Commissioner in any of these cases is subject to appeal to the Central Board of Revenue.

4. Information supplied by assessees to be confidential.

All information supplied to the Income-tax Department by assessees in the shape of any statement, return, accounts, documents, evidence, affidavit, deposition or record shall be treated as confidential; and a public servant who discloses it shall be punishable with imprisonment which may extend to six months, and shall also be liable to fine.

5. Step System and Slab System.

These are the two methods of computing income-tax on the income chargeable. Under the step system, income-tax at the rate applicable to the total income has to be paid on the whole amount of the total income; and the rates of income-tax prescribed for different amounts of total income are different, the higher the income the higher the rate. This system was in vogue prior to 1st April 1939 when it was abolished. It has been reintroduced in connection with the taxation of capital gains. As already explained in a previous chapter, capital gains exceeding Rs. 50,000 but not exceeding Rs. 2,00,000 are taxed at two annas per rupee; while capital gains exceeding Rs. 2,00,000 but not exceeding Rs. 5,00,000 are taxed at three annas per rupee. Thus an assessee making a capital gain of Rs. 60,000 will pay tax at two annas per rupee on the whole amount: and another assessee making a capital gain of Rs. 3,00,000 will pay tax at three annas in the rupee on the whole amount. This is the step system.

Under this system an injustice is done to those assessees whose taxable income just exceeds the limit where the rate changes. To avoid this, a marginal relief is granted. Thus, an assessee making a capital gain of Rs. 50,400 will not be required to pay tax on the whole amount at the rate of two annas per rupee; he will have to pay at the rate of one anna per rupee on Rs 50,000 plus one-half of the excess of his total income over Rs. 50,000, i. e., Rs. 200.

To do away with the hardship, injustice and the inequitable results of the step system of taxation, the Finance Act of 1939 introduced a new and more equitable system of taxation known as the slab system. Under this system, successive slabs or slices of income are charged at progressively higher rates of tax, the first slice bearing no tax whatever. If, for example, an assessee has an income of Rs. 15,000, he pays no tax on the first slab of Rs. 1,500, pays tax on the next slab of Rs. 3,500 at the rate of one anna per rupee, pays tax on the next slab of Rs. 5,000 at the rate of two annas per

rupee, and pays tax on the last slab of Rs. 5,000 at the rate of three and a half annas per rupee. This is the slab system of taxation.

Test Questions

1. What are the rights of appeal given to an assessee? State a few cases in which he may file an appeal.

2. By whom may an assessee be represented in income-tax proceedings?

3. Briefly state the difference between (a) original cost system and written-down value system of depreciation; (b) taxation of registered firms and unregistered firms; (c) treatment of recognised and unrecognised provident funds; (d) assessment of resident and nonresident assessees; (e) slab system and step system of taxation; (f) effect of public notice under section 22 (1) and individual notice under section 22 (2) for return of income. *(Agra B. Com. 1947)*

4. How are the following incomes treated in the assessment of an individual who is a resident and ordinarily resident?—

(a) Share of income of an undivided Hindu family;
(b) Share of profit from an unregistered firm;
(c) Income from an Indian State;
(d) Profit on sale of a capital asset; and
(e) Income from property in a foreign country. *(Agra B. Com. 1948)*

CHAPTER 24.

SOLVED QUESTIONS

1. A doctor's income consists of Rs. 5,400 from profession, 5% interest on Rs. 10,000 government securities, and Rs. 100 as director's fees.

He owns a bungalow which he uses for his own residence, the municipal valuation of which is Rs. 1,000. He paid Rs. 150 for fire insurance premium and Rs. 50 ground rent. The bungalow is mortgaged and the interest on the mortgage amounts to Rs. 800.

He paid Rs. 1,200 as premium on a policy on his own life.

Ascertain the tax payable by him for 1947–48. *(Agra B. Com. 1944)*

			Gross Income	Tax collected at source
			Rs.	Rs. a. p.
1. Interest on securities ...			500	156 4 0
2. Property income :				
Annual value restricted to 10% of total income		545		
Less one-sixth for repairs	90			
Fire premium ...	150			
Ground rent ...	50			
Mortgage interest ...	800	1,090	–545	
3. Professional income ...			5,400	
4. Other sources : Director's fees			100	
Total Income			5,455	
Less Earned income allowance being one-fifth of Rs. 5,500			1,100	
Total Income			4,355	
Gross amount of income-tax on Rs. 4,355				178 7 0
Average rate 7.86 pies per rupee.				

Exempted Income :

Life insurance premium amounting to Rs. 909, and the tax relief thereon at the average rate Rs. 37-3-0.

Gross income-tax chargeable on taxable income		178 7 0
Less Tax already collected	156 4 0	
Relief on exempted income	37 3 0	193 7 0
Amount refundable ...		15 0 0

2. From the following information relating to the previous year ended 31st March 1947, prepare the assessment of A :—

He is the chief accountant of a large mill company drawing a salary of Rs. 600 and a house-rent allowance of Rs. 50 per month. During the year he

contributed Rs. 800 to a recognised provident fund to which his employer also contributed the same amount. The interest on his provident fund account for the year was Rs. 915.

On the occasion of the company's silver jubilee he was given two months' salary as bonus during the year. His other taxable income consisted of (a) Rs. 900 as share of profits from an unregistered firm which has been taxed ; (b) Rs. 1,275 from property (c) Rs. 500 interest from tax-free government securities ; and (d) Rs. 810 received as dividends.

The premium paid on his life insurance policies amounted to Rs. 865.

(Agra B. Com. 1946)

A's Assessment for 1947–48

			Gross Income	Tax collected at source
			Rs.	Rs. a. p.
1.	Salary ...	7,200		
	House-rent allowance ...	600		
	Bonus ...	1,200	9,000	438 12 0
	Employer's P. F. contribution		800	
	Interest on P. F. ...		915	
2.	Interest on securities (Tax-free)		500	
3.	Property income —		1,275	
4.	Business : Profits from an unregistered firm (Taxed) ...		900	
5.	Other sources : Dividends gross		1,178	368 3 0
	Total Income		14,568	806 15 0
	Less Earned income allowance being 20% on Rs. 10,715 being. salary and accretion to P. F.		2,143	
	Taxable Income		12,425	
	Gross income-tax on Rs. 12,425			1,374 4 0
	Average rate of income-tax 21.23 pies per rupee.			

Exempted Income :

1.	P. F. contribution restricted to one-sixth of regular salary	1,200
2.	Life insurance premium	865
3.	Interest on P. F. assumed to be less than 6% p. a. ..	915
4.	Tax-free interest on securities ...	500
5.	Profits from an unregistered firm already taxed ...	900
		4,380

Income-tax relief thereon at 21.23 pies per rupee Rs. 484–5–0.

Gross amount of income-tax chargeable on taxable income			1,374 4 0
Less Tax collected at source	...	806 15 0	
Relief on exempted income	...	484 5 0	1,291 4 0
Net tax payable	...	Rs.	83 0 0

The amount of tax collected at source from salary has been computed as follows :—

	Rs.		
Estimated annual salary	9,000		
Less Earned income allowance	1,800		
Taxable amount	7,200		
Income-tax thereon	Rs. 493	12	0
Average rate 13.16 pies per rupee.			
Relief on P. F. contribution Rs. 800	54	13	0
Net yearly tax to be deducted ...	438	15	0
Monthly tax deduction ...	36	9	0
Hence deduction for 12 month ...	438	12	0

3. The following are the particulars of the income of D. D. Pande, a government servant, for the previous year ended 31st March 1947 :—

(a) His salary was Rs. 750 per month and his travelling allowance bills for the whole year amounted to Rs. 1,660, the actual expenditure incurred by him on travelling being Rs. 1,140.

(b) He contributed one anna in the rupee to Government Provident Fund, his employer contributing an equal amount. Interest on his provident fund account balance for the year amounted to Rs. 1,580.

(c) He owns two bungalows, one of which is let at Rs. 125 per month and the other the annual rental value of which is Rs 850 is occupied by him for his own residence. He pays Rs. 150 per year as ground rent and insurance charges in respect of the first bungalow and Rs. 210 per year in respect of the second one.

(d) His investments during the year were as follows :—(i) Rs. 5,000 5% tax-free government securities, (ii) Rs. 8,000 6% preference shares in a sugar mill company.

(e) He is insured and pays an annual premium of Rs. 1,250.

You are required to find out for his assessment of 1947-48 (i) his total income, (ii) earned income allowance that will be granted to him, (iii) his taxable income, and (iv) the amount on which he can claim exemption.

(Agra B. Com. 1947)

			Rs.
1. Salary ...	...	...	9,000
2. Interest on securities : Tax free ...		...	250
3. Property income :			
Annual letting value of both houses		2,350	
Less one-sixth for repairs	391		
Ground rent and insurance premium	360	751	1,599
4. Other sources : Dividends gross			480
		Total Income ...	11,329
		Earned income allowance	1,800
		Taxable Income ...	9,529

Exempted Income :

1. Provident fund contribution	... ...	562
2. Insurance premium	... ...	1,250
3 Tax-free interest on securities	... ...	250
		2,062

Note.—It is assumed that the dividend on *preference shares was duly* received.

4. The details of the income of an ordinary resident for the year ended 31st March 1947 are given below, and you are asked to compute his total income, taxable income and exempted income for 1947–48 assessment.

1. Salary of Rs. 300 per month for the first six months of the year, 10% of which was contributed to an unrecognised provident fund maintained by his employer

2. On 1st October, 1946 he was retrenched and on that date he received from the unrecognised provident fund Rs. 9,500, which included Rs. 6,500 for his own contribution and interest thereon. In addition was paid Rs. 5,000 by way of compensation for the loss of the employment.

3. From 1st December 1946 he was able to secure another job on Rs. 250 per month.

4. He received (a) Rs. 6,000 for an endowment insurance policy; (b) Rs. 924 as dividend from company; (c) Rs. 150 tax-free interest from government securities; (d) Rs. 55 interest on postal savings bank account; (e) Rs. 430 as directors' fees; (f) Rs. 500 being one-half share of a Hindu undivided family; (g) Rs. 3,750 interest on treasury bills; (h) Rs. 350 as rent from land situated in the U. P. and Rs. 500 as rent from land owned in Bharatpur State; (i) Interest on Rs. 1,50,000 3½% government paper; (j) A monthly pension of Rs. 125 as an ex-employee of Gawlior State.

5. Rs. 5,400 being one-third share profits from an unregistered firm.

6. Income from a registered firm; Share of profits Rs. 3,150; interest on capital Rs. 500; and commission Rs. 350.

7. He made a profit of Rs. 10,000 from speculation in Indore State and a loss of Rs. 15,000 from speculation in Jaipur state.

8. Income of £375 from sterling securities, one-half of which was actually received in British India and the balance was reinvested in London.

9. In May 1946 he started the construction of a residential house which was completed in January 1947. It cost Rs. 25,000 which was borrowed at 6 per cent. per annum. The municipal valuation of the house has been fixed at Rs. 1,200.

He paid Rs. 6,500 as premia on his life policies for Rs. 50,000

(a) Indian Income :

				Rs.	
1. Salary as such		2,550			
P. F. money		3,000	...	5,550	
5. Interest on securities :	Taxed		...	5,250	
	Tax-free		...	150	
3. Business :	Profits from registered firm		...	4,000	
	Profits from unregistered firm			5,400	
5. Other sources :	Dividend gross		...	1,344	
	Director's fees		...	430	
	Interest on treasury bills			3,750	
					25,874

(b) Foreign income :

1. Remitted income from Indian State :			
Agricultural income ...	500		
Pension ...	1,500	2,000	
Remitted income from other foreign countries (£187-10-0 at one shilling six pence)		2,500	
2. Unremitted foreign income being less than Rs. 4,500 ...		—	
3. Unremitted Indian State income :			
Profit in Indore State	10,000		
Loss in Jaipur State	–15,000		
	– 5,000		4,500
Total Income		Rs.	30,374
Less Earned income allowance being one-fifth of Rs. 11,480			2,296
Taxable Income		Rs.	28,078

Exempted Income :

1. Tax-free interest on securities ...	150
2. Profit from unregistered firm ...	5,400
3. Life insurance premium restricted to 10 per cent. of the sum assured ...	5,000
	10,550

Notes. The loss incurred in an Indian State cannot be set off against British Indian income ; it can be carried forward and set off only against future Indian State income from the same business.

The income from house property intended for residential purposes and constructed between 1st April 1946 and 31st March 1950 is exempted for two assessment years.

5. An individual had the following income in British India during the calendar year 1946 :—(a) Property—annual letting value Rs. 48,000 ; (b) Salary Rs. 12,000 ; (c) 8 anna share of profits in a registered firm Rs. 10,000 ; and (d) 8 anna share of loss in an unregistered firm Rs. 5,000.

You are required to determine his taxable income, and find out the tax payable by him after considering the following facts :—

1. Rs. 2,000 a year is payable for the ground rent of the land on which the property is situated, but as this sum was in arrears since 1943, Rs. 8,000 had to be paid during the year.
2. The property has been constructed with a borrowed capital of Rs. 1,00,000 on which interest at 4% p. a. is payable.
3. He spent a sum of Rs. 6,000 on the repair of the property and paid Rs. 1,000 as salaries to the staff employed for collecting the rent.
4. The particulars of his life insurance policies are :—(a) Whole-life policy on his own life, capital sum assured Rs. 50,000 and premium paid Rs. 2,000 ; (b) Endowment policy on the life of his wife, capital sum assured Rs. 30,000 and premium paid Rs. 5,000 ; (c) Marriage endowment policy for daughter for Rs. 10,000 payable on the happening of the marriage but not otherwise, premium paid Rs. 1,000.

(Agra M. Com. 1945)

Assessment for 1947–48

			Gross Income	Tax collected at source		
			Rs.	Rs.	a.	p.
1. Salary			12,000	793	12	0
2. Property income :						
Letting value		48,000				
Less one sixth for repairs	8,000					
Ground rent	2,000					
Interest	4,000					
Collection charges	1,000	15,000	33,000			
3. Business : Profits from registered firm			10,000			
Total Income			55,000			
Less Earned income allowance ...			4,000			
Taxable Income			51,000			
Gross amount of income-tax on taxable income				13,187	8	0
Average rate of income-tax 49·65 pies per rupee.						
Gross amount of super-tax on total income at the rates applicable in 1947-48 assessment				6,906	4	0
				20,093	12	0

Exempted Income :

Life insurance premium Rs. 6,000 and relief thereon			Rs. 1,551	9	0
Gross amount of tax			20,093	12	0
Less Tax collected at source ...	793 12 0				
Relief on exempted income ..	1'551 9 0		2,345	5	0
Tax payable			Rs. 17,748	7	0

6. C is employed as an engineer in a sugar mill on Rs. 500 per month. He contributes 10% of his salaray to an approved superannuation fund and also pays Rs. 3,600 annually as premia on his life policies for Rs. 25,000. His income from investment is as follows :—

1. A tax-free dividend of Rs. 15 per shase on 90 shares in a company, 60% of whose profits are taxable ;
2. A tax-free dividend of 10% on 15 shares of Rs. 500 each in a company whose entire profits are taxed ;
3. 5% interest on Rs. 15,000 port trust debentures ;
4. 3½% interest on Rs. 25,000 government paper ;
5. 4½% interest on £ 2,000 debenture stock of foreign company.

His bank charged him Rs. 15 for collecting interest and dividends. He also received Rs. 118 as interest on a bank fixed deposit and 5% interest on a mortgage of Rs. 15,000.

Prepare his assessment for 1947–48.

C's Assessment for 1947–48

	Gross Income	Tax collected at source		
	Rs.	Rs.	a.	p.
1. Salary ...	6,000	180	0	0

2. Interest on securities	...	2,825		
Less Bank commission	...	15	2,810	507 13 0
3. Dividend gross	...		2,752	652 6 0
Interest on fixed deposit	...		118	
Interest on mortgage	...		750	
Total Income			12,430	1,340 3 0
Less Earned income allowance			1,200	
Taxable Income			11,230	

Gross income-tax on taxable income	...	1,112 13 0
Average rate of income-tax 19.02 pies per rupee		

Exempted Income :

1. Contribution to approved S. F.	600
2. Life insurance premium	1,471
	2,071

Amount of income-tax relief thereon Rs. 205-3-0

Gross income-tax chargeable on taxable income		1,112 13 0
Lses Tax collected at source	1,340 3 0	
Relief on exempted income	205 3 0	1,545 6 0
Amount refundable		Rs. 432 9 0

7. An American came out to Bombay for the first time on 1st July 1946 to take up the post of chief chemist in a large chemical works under a five year's agreement and on a monthly salary of Rs. 2,000 payable on the last day of each month. His other income in British India up to 31st March 1947 was as follows :—

1. One half-year's interest on Rs. 25,000 3% government securities ;
2. 6% dividend (less tax) on Rs. 10,000 preference shares in a jute mill company ,
3. A dividend of Rs. 3 and a bonus of Rs. 2 per share (both free of tax) on 1,000 shares in an engineering company, 80% of whose profits are taxable ;
4. Rs. 250 as directors' fees.

He earned Rs. 50,000 from agriculture in America, half of which was remitted to him in Bombay in October 1946.

He is insured for 10,000 dollars with an American insurance company and he paid in New York 400 dollars as premium.

Prepare his income-tax assessment for the year 1947-48.

Assessment for 1947-48

	Gross Income	Tax collected at source
(a) **Indian Income**	Rs.	Rs. a. p.
1. Salary	18,000	1,806 4 0
2. Interest on securities	375	117 3 0
3. Dividend : Jute mill shares	600	187 8 0
Engineering company shares	6,666	1,666 11 0
Director's fees	250	
		3,777 10 0
	25,891	

(b) **Foreign Income :**		
Remitted to British India	25,000	
Total Income	50,891	
Less Earned income allowance	4,000	
Taxable Income	46,891	
Gross amount of income-tax on Rs. 46,891	...	11,903 7 0
Gross amount of super-tax on Rs. 50,891	...	4,996 14 0
		16,900 5 0
Total tax chargeable	...	16,900 5 0
Less tax collected at source	...	3,777 10 0
Amount of tax payable		13,122 11 0

Notes.—The assessee in this case is a resident not ordinarily resident.
The American agricultural income is earned income.

8. A retired official of the U. P. Education Department, has been employed as the Principal of a college in Jaipur State; and the particulars of his income for the year ended 31st March 1947 are as follows :

(a) A pension of Rs. 250 p. m. from the U. P. Government received in Jaipur State ;

(b) Taxable income from property situated in Agra Rs. 500 ;

(c) Income from money-lending business carried on in Meerut Rs. 10,000 ;

(d) Salary of Rs. 750 per month together with a dearness allowance of Rs. 50 per month in Jaipur State, out of which Rs. 5,000 was sent to Meerut for being used in money-lending business ;

(e) Rs. 1,500 received in Jaipur State as examiner's remuneration from Allahabad and Delhi universities ;

(f) Rs. 500 bank interest received in Jaipur State ;

(g) Rs. 2,500 royalty on books received in Meerut from an Agra firm of publishers ;

(h) Rs. 650 travelling allowance received from the University of Rajputana for attending university meetings.

Show how his tax liability will be ascertained for the financial year 1947–48 (a) when he is an ordinary resident, (b) when he is a resident not ordinarily resident, and (c) when he is a non-resident. You are not required to calculate the amount of tax.

His tax liability will be ascertained as follows :—

	(a) Rs.	(b) Rs.	(c) Rs.
British Indian Income :			
1. Salary (Pension)	3,000	3,000	3,000
3. Property income	500	500	500
3. Money-lending business	10,000	10,000	10,030
4. Royalty	2,500	2,500	2,500
	16,000	16,000	16,000

Foreign Income :

1. Remitted out of salary		5,000	5,000	—
2. Unremitted Jaipur State Income :				
Salary ...	4,600			
Bank interest ...	500			
Examiner's remuneration ...	1,500			
	6,600			
Less allowance ...	4,500	2,100	—	—
Total Income ...		23,100	21,000	16,000
Less Earned income allowance ...		4,000	4,000	3,100
		19,100	17,000	12,900

(a) As an ordinary resident, he will pay tax on Rs. 17,000 (i. e., the taxable income minus the unremitted Jaipur State income) at the average rate applicable to Rs. 19,100.

(b) As a resident not ordinarily resident, he will pay tax on Rs. 17,000.

(c) As a non-resident, his total world income will be Rs. 16,000 plus all his foreign income amounting to Rs. 11,600, i. e., Rs. 27,600. He will pay income-tax on Rs. 12,900 at the average rate applicable to his total world income ; and he will pay super-tax at the average rate applicable to his total world income. The amount of super tax on the total world income will be computed with due regard to earned and unearned income.

Note. The unremitted Jaipur State salary, not being actually taxable, is *not entitled to earned income allowance.*

9. From the following particulars relating to the year ended 31st March 1947 furnished by A, who is trading as a general merchant, ascertain his total income and the amount of income entitled to income-tax relief :—

He owns properties in four places and their annual values are Rs. 57,380, Rs. 9,840, Rs. 2,060 and Rs. 2,000 respectively. He is interested in the following concerns of which he is a partner :—

A. B. & Co. (registered) whose assessable income for the year ended Diwali Samvat 2003 is Rs. 41,708 and A's share is 8 annas.

C. D. & Co. (unregistered) whose assessable income for the year 1946 amounts to Rs. 24,331 and A's share is 6 annas.

His income & Expenditure Account for the year ended 31st March 1947 is as follows :—

	Rs.		Rs.
Property Expenses :		Property Rents ...	78,000
Repairs ...	20,000	Share of Profits :	
Collection Charges ...	4,660	A. B. & Co. ...	20,854
Ground Rent ...	2,824	C. D. & Co. ...	9,124
Insurance Premium ...	1,568	Remuneration as	
Salaries and Wages ...	27,000	liquidator ...	1,40,000
General Expenses ...	3,000	Profits of his own	
Reserve for Bad Debts ...	17,800	business ...	96,000
Interest to mortagees of		Interest on tax-free	
property ...	18,000	government securities ...	1,20,000
Other interest ...	72,000	Interest on Loans ...	1,80,000
Net Profit ...	4,77,126		
	6,43,978		6,43,978

Rs. 500 being collection charges in connection with properties has been debited to Salaries and Wages Account by mistake.

He also owns a property which is used solely as his residence and the municipal valuation of which is Rs. 90,000. Insurance premium and ground rent for the same amounted to Rs. 2,976, which is not included in any figure stated above. *(Agra B. Com. 1945)*

1. Income from property—				
Annual value of property let		78,000		
Less 1/6 for repairs	13,000			
Insurance	1,568			
Ground Rent	2,824			
Interest on Mortgage	18,000			
Collection Charges 6%	4,680	40,072	37,928	
Annual value of property occupied		54,483		
Less 1/6 for repairs	9,080			
Insurance, Ground Rent	2,976	12,056	42,427	80,355
2. Interest on securities—Tax-free				1,20,000
3. Business :				
Profits from registered firm		...	20,854	
,, ,, unregistered firm		...	9,124	
Proprietary Business (Loss)*		...	–5,500	24,478
4. Other sources :				
Interest on Loans		...	1,80,000	
Remuneration as Liquidator		...	1,40,000	3,20,000
		Total income Rs.		5,44,833

*This is computed as follows :—

Gross Profit from proprietary Business		96,000
Less Expenses : Salaries and Wages	26,500	
General Expenses	3,000	
Interest	72,000	1,01,500
	Loss Rs.	5,500

Exempted income (entitled to income-tax relief) :

1. Tax-free interest	1,20,000
2. Profits from unregistered firm which has been taxed	9,124
Rs.	1,29,124

10. There is a registered firm having three partners A, B, and C who share profits and losses in the proportion of 2, 2 and 1 respectively. A retires on 30th September 1946 and D (who has previously been a salaried assistant on Rs. 300 a month) is admitted as a partner on that date, the shares of B, C and D being 4, 3 and 3 respectively. B, C and D further agree not to allow or charge any interest on current accounts.

The Profit & Loss of the firm for the year ended 31st March 1947 is as follows :—

		Rs.			Rs.
Stock on 1-4-1946	...	20,000	Sales	...	1,50,000
Purchases	...	80,000	Stock on 31-3-1947		15,000
Staff Salaries	...	12,000	Interest on C's Current		
Rent	...	6,000	Account	...	320
General Expenses	...	1,700			
Subscriptions: Business	...	60			
Charitable		80			
Interest on Current Accounts :					
A	...	560			
B	...	440			
Balance	...	44,480			
		1,65,320			1,65,320

The other taxable income of the partners was :—

A—Dividends from companies (net) Rs. 3,960.
B—Interest on Bank deposit Rs. 500.
C—Nil.
D—Salary as assistant in the firm.

Show how the assessment would be made for the year 1947-48, if the taxable profits of the business are attributed equally to the two halves of the year.

(a) Computation of the firm's total income.

			Rs.
Profit as per Profit & Loss Account	...		44,480
Add Items disallowed :			
Charity	...	80	
Interest on partners' current Accounts		1,000	1,080
			45,560
Less interest charged on C's current account			320
			45,240

(b) Allocation of firm's income between partners.

	A	B	C	D
	Rs.	Rs.	Rs.	Rs.
Interest	560	440	-320	—
Balance for first six months (2, 2, 1) ...	8,776	8,776	4,388	—
Balance for next six months (4, 3, 3) ...	—	9,048	6,786	6,786
	9,336	18,264	10,854	6,786

(c) Statement of partner's total income.

	A	B	C	D
	Rs.	Rs.	Rs.	Rs.
1. Salary	—	—	—	1,800
2. Profits from regd. firm	9,336	18,264	10,854	6,786
3. Dividend gross	5,760	—	—	—
4. Interest on bank deposit	—	500	—	—
Total Income	15,096	18,764	10,854	8,586
Less Earned income allowance	1,866	3,652	2,170	1,717
Taxable Income	13,230	15,112	8,684	6,869

11. A and B are partners in a registered firm sharing profits and losses equally, and the following is their Profit & loss Account for the year 1946 :—

		Rs.			Rs.
Salaries	...	10,750	Gross Profit	...	51,040
Rates and insurance	...	1,200	Tax-free interest on government securities		900
Travelling Expenses	...	954	Profit on sale of investments		1,200
Interest on Bank loan	...	1,650			
Legal Charges	...	163			
Discounts	...	897			
Carriage	...	601			
General Charges	...	2,050			
Marketing	...	2,300			
Depreciation on motor-car		500			
Interest on Capital : A	...	1,700			
B	...	1,550			
Reserve for Bad Debts	...	1,000			
Net Profit	...	27,825			
		53,140			53,140

Take the following matters into consideration, and then compute the total income of the firm and allocate it between the partners :—

(a) Salaries include a partnership salary of Rs. 250 p. m. to B.
(b) Legal charges consist of Rs. 100 for alteration of the partnership agreement and the balance for debt collection.
(c) Rs. 200 premium paid on an insurance policy on the life of a debtor is included in rates and insurance.
(d) General charges include Rs 210 for additional filing cabinets and Rs. 360 for a new portable typewriter purchased, and Rs. 301 charity.
(e) The motor-car was purchased for Rs, 10,875 in 1945 and is used solely for business purposes. The depreciation of the car was claimed in the 1946-47 assessment at 20%.

(a) **Computation of the firm's total income.**

			Rs.
Net Profit as per Profit & Loss Account			27,825
Add Expenses not allowed :			
Partner's salary	...	3,000	
Insurance premium	...	200	
Legal charges	...	100	
Capital expenditure	...	570	
Charity	...	301	
Depreciation	...	500	
Reserve for bad debts	...	1,000	
Interest on capital	...	3,250	8,921
			36,746
Less Profit on sale of investments being capital profit			1,200
			35,546
Less Depreciation of motor-car 20% on Rs. 8,700			1,740
Total income of the firm			33,806

(d) **Allocation of firm's total income between partners.**

		A	B
		Rs.	Rs.
Salary	...	—	3,000
Interest on capital	...	1,700	1,550
Tax-free interest	...	450	450
Balance	...	13,328	13,328
		15,478	18,328

Note.—If the firm is unregistered, the tax-free interest will not be shown separately in the above allocation statement.

12. The Profit & Loss Account for 1946 of a firm consisting of three partners A B and C (with shares of 4, 3 and 1) showed a net loss of Rs. 16,000 after charging the following items : Interest on Capital A Rs. 3,000 ; B Rs. 2,000 and C's salary of Rs. 3,000.

A's taxable income from other sources is Rs. 5,000, while B and C have no other income.

Explain how assessments would be made (a) when the firm is registered and (b) when it is unregistered. *(Agra B. Com. 1945)*

After making adjustment for interest on partners' capital and the partnership salary, the firm's loss would be Rs. 8,000 ; and the respective shares of three partners will be as follows :—

		A	B	C
		Rs.	Rs.	Rs.
Interest on Capital	...	3,000	2,000	—
Salary	...	—	—	3,000
Share of firm's loss	...	–8,000	–6,000	–2,000
		–5,000	–4,000	1,000

***(a)* When the firm is registered.**

A can set off his shares of the firm's loss (Rs. 5,000) against his other income of Rs. 5,000, and will not be liable to pay any tax.

B can carry forward for six assessment years his share of the firm's loss (Rs. 4,000) for set off against his future share of profits from the same firm.

C is not liable to tax as his total income is below the minimum taxable limit.

***(b)* When the firm is unregistered.**

The unregistered firm itself can carry forward its loss of Rs. 8,000 for six assessment years to be set off against its future income.

A cannot set off his share of the firm's loss against his other income. He will therefore pay tax on full Rs. 5,000.

B cannot carry forward his share of the firm's loss, and C is not liable to any tax.

13. A, B and C are equal partners in a registered firm, whose total income for the year ended 30th June 1945 amounted to Rs. 36,000. On 1st January 1946 A retired and D came in as a partner taking over A's share. The firm's total income for the year ended 30th June 1946 was Rs. 48,000.

State clearly how the assessment of the firm and its partners would be made for the financial years 1946–47 and 1947–48 respectively, assuming that the partners have no other income. *(Agra B. Com. 1943)*

(a) The assessment for 1946–47 would be made on the firm of B, C and D, because the firm is so constituted at the time of assessment; but the income of the firm for the previous year ended 30th June 1945 having been determined, it would be divided for assessment purpose between A, B ane C (and not between B, C and D), since it is A, B and C who were entitled to that income.

A, B and C would each be assessed on Rs. 12,000, while D would pay no tax in respect of the firm's income for the year ended 30th June 1945 because he did not receive anything out of it.

(b) Assuming that the firm's income for the year ended 30th June 1946 has been earned evenly throughout the period, the profits for the six months ended 1st January 1946 would be Rs. 24,000 and those for the remaining six months would also be the same.

Thererefore for purposes of 1947–48 assessment, the total income of the firm of B, C and D would be allocated as follows :—

	A Rs.	B Rs.	C Rs.	D Rs.
Profits for the first six months of the previous year ended 30th June 1946	8,000	8,000	8,000	—
Profit for the remaining six months	—	8,000	8,000	8,000
	8,000	16,000	16,000	8,000

and each partner would pay tax on his respective share of the firm's income.

14. A, B and C are equal partners in a registered firm, whose loss for the year ended 30th September 1945 is worked out at Rs. 15,000. The other taxable income of the partners for the same period is A Rs. 5,000; B Rs. 7,000; C Rs. 4,000.

On 1st February 1946 A retired and D came in as a partner taking over A's share.

The firm's loss for the year ended 30th September 1946 is Rs. 6,000, the partners having no other income for that period.

Show how assessment would be made for 1946 47 and 1947-48.

(a) The assessment for 1946-47 would be made on the firm of B, C and D, because the firm is so constituted at the time of assessment; but the loss having thus been assessed would be allocated between A, B and C Rs. 5,000 each.

A can set off his share of the firm's loss against his other income of Rs. 4,000 and will not therefore have to pay tax.

B naving set off his share of the firm's loss against his other income would have a total income of Rs. 2,000 and would not be liable to pay any tax.

C would first set off Rs. 4,000 out of his share of the firm's loss against his other income, and would then be entitled to carry forward the balance of loss (Rs. 1,000) for six assessment years for set-off against his future share of profits from the same firm.

(b) Assuming that the firm's loss for the four months ended 1st February 1946 is Rs. 1,500 and that for the remaining eight months till 30th September 1946 is Rs. 4,500, then for purposes of 1947-48 assessment the loss of Rs. 6,000 would first be assessed upon B, C and D and would then be apportioned amongst the partners as follows:—

	A	B	C	D
	Rs.	Rs.	Rs.	Rs.
Loss for the first four months of the previous year ended 30th Septemher 1946 ...	500	500	500	—
Loss for the remaining eight months of the previous year	—	1,500	1,500	1,500
Loss	500	2,000	2,000	1,500

A, having left the firm, has no right to carry forward his share of the firm's loss, because a business loss can be carried foward and set off only against the future profits of the same business.

B, C and D each can carry forward his share of the firm's loss for six assessment years.

15. The following is the Profit & Loss Account of Mr. Jamshedji for the year ended 31st March 1947 :—

	Rs.		Rs.
Salaries ...	40,000	Gross Profit ...	5,00,000
Allowance to widows of deceased employees	3,000	Profit on sale of manchinery	50,000
Postage and telegram	1,000		
Secret commission	10,000		
Donation to Red Cross Fund	10,000		
Rent	6,000		
Staff Provident Fund contribution	5,000		
Loss on sale of investments	1,00,000		
Interest on capital	5,000		
Net Profit	3,70,000		
	5,50,000		5,50,000

(a) The original cost of machinery sold during the year was Rs. 1,00,000 and depreciation allowed for income-tax purposes to date was Rs. 30,000.

(b) Mr. and Mrs. Jamshedji have a partnership business in which the assessable profit for 1947–48 assessment is determined at Rs. 60,000 as a registered firm. The whole capital of the firm has been contributed by Mr. Jamshedji. The two partners share profits equally.

(c) Mr. Jamshedji has made a revocable deed of settlement, the income from which for the 1947–48 assessment works out at Rs. 10,000 from dividends. Under the settlement the whole income is to go Mrs. Jamshedji for her life.

(d) Mr. Jamshedji has made another revocable deed of settlement, whose income for the 1947–48 assessment works out at Rs. 15,000 from dividends. Under this settlement, the whole income is to be enjoyed by the three children of the settler all of whom are minors.

Prepare the respective tax liabilities of Mr. Jamshedji, Mrs. Jamshedji, and the trustees for the minor children for the assessment year 1947–48.

(R. A. Final 1944)

		Rs.	Rs.
Profit as per Profit & Loss Account		...	3,70,000
Add Expenditure not allowed :			
Secret commission	...	10,000	
Donation to Red Cross Fund	...	10,000	
Loss on sale of investments	...	1,00,000	
Interest on capital	...	5,000	1,25,000
			4,95,000
Less Capital gain on sale of machinery being excess of sale price over the cost	...		20,000
Taxable profits			4,75,000

NOTE. The written-down value of machinery sold is Rs. 70,000. It must have been sold for Rs. 1,20,000 in order to make a profit of Rs. 50,000. Now out of this Rs. 50,000, Rs. 20,000 is capital gain according to the provisions of section 10 (2) (vii) relating to obsolescence loss.

This capital gain of Rs. 20,000 will be set off against the capital of loss of Rs. 1,00,000 on the sale of investments, and the remaining loss of Rs. 80,000 will be carried forward set-off against the future capital gains for six years.

Mr. Jamshedji's tax liability for 1947–48 assessment

		Rs.
1. Business : Profits of his own business	...	4,75,000
Profits from registered firm	...	30,000
2. Other sources :		
Wife's share of registered firm's profits	...	30,000
Income from the two settlements	...	25,000
Total Income	...	5,60,000
Earned income allowance	...	4,000
Taxable Income	...	5,56,000

NOTE. It is assumed that in the case of both the settlements the assets remain the property of the settler and it is only the income that is settled. In these circumstances Mrs. Jamshedji and the minor children will not be liable to tax.

If, on the other hand, it is assumed that both the assets and their income are settled on the beneficiaries, then in the first case the dividend income of Rs. 10,000 will be deemed to be the income of Mrs. Jamshedji provided the settlement is not revocable during her lifetime and Mr. Jamshedji receives no benefit direct or indirect.

In the caae of the second settlement, even when it is the settlement of assets as well as income, the income of Rs. 15,000 will be deemed to be the income of Mr. Jamshedji and not that of minor children, because the settlement is a revocable one.

16. Mr and Mrs. Vikaji trade in the name of Vera & Co., whose Profit & Loss Account for the year ended 31st March 1947 is given below :—

		Rs.		Rs.
Salaries and wages	...	50,000	Gross Profit ...	4,80,000
Trade expenses	...	10,000	Interest from tax-free	
Postage and telegrams	...	1,000	government securities ...	20,000
Rent	...	10,000		
Loss on sale of machinery	...	80,000		
Repairs and replacements	...	25,000		
Loss by embezzlement	...	9,000		
Bonus to employees	...	10,000		
Commission	...	5,000		
Net Profit :				
Mr. Vikaji	1,50,000			
Mrs. Vikaji	1,50,000	3,00,000		
		5,00,000		5,00,000

(a) The loss of Rs. 80,000 on sale of machinery is arrived at as follows :—

		Rs.
Original cost of machinery	...	2,00,000
Less Sale proceeds thereof	...	1,20,000
	Loss	80,000

On this machinery depreciation allowed for income-tax purposes up to the date of sale was Rs. 50,000.

(b) Mr. and Mrs. Vikaji have made a revocable deed of settlement, the income from which is to go to their only son Rustomji, who is doing his separate business from which he has earned Rs. 30,000. The income from dividends under this settlement is Rs. 10,000. Rustomji is 29 years of age.

(c) Mr. and Mrs. Vikaji have made an irrevocable settlement in which they are the trustees and also the life tenants enjoying the income of the trust in equal shares, which for the year ended 31st March 1947 was Rs. 20,000 from dividends. The trustees were empowered to make changes in the investments of the trust; and on account of such changes there was a profit of Rs. 30,000 made during the year.

(d) Mr. Vikaji during the year suffered a loss of Rs. 10,000 in cotton business carried on in Indore State.

(e) Mrs. Vikaji during the year earned a profit of Rs. 5,000 in silver business done in Baroda State, which amount was not brought into British India.

Prepare the respective tax liabilities of Mr. Vikaji, Mrs. Vikaji and Mr. Rustomji for the assessment year 1947-48. Do not calculate the actual amount of tax payable, and state in the form of footnotes any assumptions you may have made in your answer. *(R. A. Final 1945)*

			Rs.
Profit as per Profit & Loss Account	...		3,00 000
Add loss on sale of machinery	...		80,000
Less Obsolescence allowance		30,000	3,80,000
Tax-free interest on securities		20,000	50,000
	Taxable income from business		3,30,000

Mr. Vikaji's tax liability for 1947-48 assessment

			Rs.
1.	Interest on securities : Tax-free own share	...	10,000
2.	Business . half share of firm's profit assumed to be registered one	...	1,65,000
3.	Other sources :		
	Wife's share of tax-free interest on securities	...	10,000
	Wife's share of registered firm's profits	...	1,65,000
	Income from settlement in favour of Rustomji	...	10,000
	Income from trust in favour of both Mr. and Mrs. Vikaji		50,000
	Total Income		4,10,000
	Earned Income allowance		4,000
	Taxable income		4,06,000

Mr. Rustomji's total income is Rs. 30,000 on which he will get an earned income allowance of Rs. 4,000. He will therefore pay tax only on Rs. 26,000.

It is assumed that in both the settlements it is the income that is transferred and not the assets.

Mrs. Vikaji's silver business profit of Rs. 5,000 made in Baroda State will be set off against Mr. Vikaji's cotton loss sustained in Indore State, and the balance of his loss not so set off (Rs. 5,000) will be carried forward for being set off against the profits of his Indore cotton business.

17. The Profit & Loss Account of Vikaji for the year ended 31st March 1947 was as under :—

		Rs.			Rs.
Salaries	...	1,57,500	Gross Profit	...	3,57,000
General charges	...	4,500	Bank deposit interest	...	1,530
Ground rent	...	800	Dividends (net)	...	3,960
Rates	...	5,000			
Municipal tax on business premises	...	2,500			
Repairs to premises	...	3,750			
Carriage	...	7,010			
Advertising	...	4,300			
Discounts and bad debts	...	6,430			
Bad Debts Reserve	...	1,350			
Subscriptions	...	120			
Patent royalties	...	500			
Interest on mortgage	...	1,200			
Interest on capital	...	9,000			
Net Profit	...	1,58,530			
		3,62,490			3,62,490

After taking following information into account, you are required to prepare computation of Vikaji's assessment for the assessment year 1947-48. You are not required to calculate the amount of income-tax and super-tax.

1. Salaries include Rs. 16,000 on account of Vikaji's salary.

2. General charges include (a) Rs. 260 legal expenses *re* purchase of business premises ; (b) Rs. 360 legal expenses *re* debt collecting , and (c) Rs. 210 legal expenses *re* employment agreements with travellers.

3. *The business premises are owned by Vikaji.*

4. Repairs to premises include Rs. 1,750 in respect of improvements.

5. Advertising comprises Rs. 3,000 cost of permanent signs and Rs. 1,300 insertions in trade papers.

6. Subscriptions consist of Rs. 50 to a local hospital, Rs. 40 charity and Rs. 30 to a trade association.

7. Vikaji created an irrevocable trust on 1st April 1946 whereby he settled shares of the value of Rs. 5,00,000 and a house property of the value of Rs. 3,00,000, the income of which is to go to his wife for her life, and after her death to Vikaji if he survived her. The trust income was dividends gross Rs. 20,000 and property income Rs. 10,000. At the date of the assessment for 1947-48 both the husband and the wife are alive.

8. Vikaji's other income was as follows :—

		Rs.
(a) Loss in silver speculation in Bombay	...	10,000
(b) Business income in Baroda State not brought into British India ...	...	30,000
(c) Dividend from companies registered in Hyderabad State and deposited there in a bank	...	20,000
(d) Loss in cotton speculation in Indore	...	15,000

He paid life insurance premiums amounting to Rs. 8,000.

(R. A. Final 1946)

			Rs.
Profit as per Profit & Loss Account	...		1,58,530
Add Expenditure not allowed :			
Proprietor's salary	...	16,000	
Legal expenses being capital expenditure		260	
Cost of building improvements	...	1,750	
Advertising being capital expenditure		3,000	
Charitable subscriptions	...	90	
Bad debts reserve	...	1,350	
Interest on capital	...	9,000	31,450
			1,89,980
Less Dividends	...		3,960
Taxable income from business			1,86,020

Vikaji's Assessment for 1947-48

			Rs.
British Indian Income :			
1. Business profits	...		1,86,020
2. Other sources :			
Dividends gross	...		5,760
Wife's income	...		30,000
			2,21,780
Less Loss in silver speculation in Bombay			10,000
			2,11,780
Foreign Income :			
Unremitted Indian State income in excess of Rs. 4,500 ...	...	45,500	
Less Loss in an Indian State	...	15,000	30,500
Total Income			2,42,280
Earned income allowance			4,000
Taxable Income			2,38,280

The amount of tax payable by him will be that on Rs. 2,38,280 less Rs. 1,800 income-tax collected at source on dividends and less a rebate of income-tax on life insurance premium amounting to Rs. 6,000 and a rebate of both income-tax and super-tax on the unremitted Indian State income of Rs. 30,500.

Note.—As the shares and the house have been transferred to the wife without consideration, the income therefrom will be deemed to be the income of Mr. Vikaji.

18. Given below is the Profit & Loss Account of a limited company for the year ended 31st March 1947 :—

		Rs.			Rs.
Salaries and bonus	...	1,00,000	Gross Profit	...	5,00,000
Office rent	...	10,000	Interest	...	10,000
Fire insurance premium	...	10,000	Profit on sale of		
Postage and stationery	...	10,000	Shares	...	25,000
General charges	...	20,000			
Reserve for Dapreciation		25,000			
Income-tax	...	50,000			
Provision for Taxation	...	2,00,000			
Net Profit	...	1,10,000			
		5,35,000			5,35,000

You are required to prepare a statement showing the taxable income of the company after considering the following :—

(a) General charges included Rs. 5,000 for advertising ; Rs. 1,000 for charity ; Rs. 2,000 paid to a motor-car company for exchanging the old car for a new one ; and Rs. 5,000 for miscellaneous repairs.

(b) The depreciation admissible to the company is worked out at Rs. 15,000 only.

(c) The shares held by the company were sold in May 1946, and the company contends that they were purchased in 1925, and it is no part of its business to deal in shares.

(d) The depreciation reserve was separately invested in securities, and an amount of Rs. 20,000 derived therefrom was directly credited to the Reserve Account without being shown in the Profit & Loss Account. *(Agra M. Com. 1945)*

				Rs.
Profit as per Profit & Loss Account			...	1,10,000
Add Expenditure disallowed :				
Charity	...	1,000		
Motor car purchased	...	2,000		
Reserve for depreciation		25,000		
Income-tax	...	50,000		
Provision for taxation	...	2,00,000		2,78,000
				3,88,000
Less Expenditure allowed :				
Depreciation allowable			...	15,000
				3,73,000
Add Interest on securities not shown in the Profit & Loss Account			...	20,000
				3,93,000
Less Capital gain on sale of Shares			...	25,000
		Taxable income from business		3,68,000
		Taxable capital gains	...	25,000
		Total Income of the company		3,93,000

19. The following is the Profit & Loss Account of a sugar mill company for the year ended 30th June 1946 :—

	Rs.		Rs.
Stocks on 1-7-1945 ...	2,85,000	Sales ...	8,50,375
Cane used ...	5,25,000	Stock on 31-6-1946 ...	5,35,280
Manufacturing Expenses ...	1,14,372	Dividends ...	2,000
Excise duty ...	1,85,000	Interest on investments ...	9,365
Establishment ...	75,850	Rent from farms land ...	450
General charges ...	37,809	Rent from staff quarters ...	4,200
Marketing ...	5,684	Net Loss ...	22,545
Repairs and renewals ...	18,000		
Directors' fees ...	5,000		
Managing Agents' remuneration	60,000		
Depreciation ...	75,000		
Income-Tax ...	37,500		
	14,24,215		14,24,215

Prepare the company's assessment for 1947-48 after taking the following information into account :—

1. Cane used includes Rs. 62,000 being the cost of cane grown on the company's own agricultural farm, the average market price of the same being Rs. 75,000.

2. General charges include Rs. 1,500 contributed towards the building of a dharmshala.

3. Rs. 2,100 being the cost of replacement of rollers, Rs. 8,500 for additions to railway siding, and Rs. 1,500 repairs to staff quarters have been charged to repairs and renewals account.

4. The admissible depreciation is worked out at Rs. 61,200.

5. Sugar worth Rs. 101 was given away free to an orphanage.

6. The investments are all in government securities.

		Rs.
Loss as per Profit & Loss Account ...		-22,545
Add Expenditure not allowed :		
Charity for dharamshala ...	1,500	
Addition to railway siding ...	8,500	
Repairs to staff quarters ...	1,500	
Sugar given away free ...	101	
Depreciation charged ...	75,000	
Income-tax ...	37,500	1,24,101
		1,01,556
Less Expenditure allowed : Depreciation ...		61,200
		40,356
Less Agricultural income from cane supplied	13,000	
Dividends ...	2,000	
Interest on securities ...	9,365	
Rent from farm land ...	450	
Rent from staff quarters ...	4,200	29,015
∴ Taxable income from business		11,341

Company's Assessment for 1947–48

			Rs.
1. Interest on securities (income-tax deducted therefrom being Rs. 4,256–13–0)			13,621
2. Property income : Annual rent	4,200		
Less one sixth	700		3,500
3. Business profit ...			11,341
4. Dividends gross (income-tax thereon being Rs. 909–1–0) ...			2,909
Total Income of the company			31,371

Income-tax on total income at 5 annas	9,803	7	0
Corporation tax on total income at 2 annas	3,921	6	0
Additional super-tax assumed to be nil			
	13,724	13	0
Less income-tax collected at source ...	5,165	14	0
Tax payable	8,558	15	0

20. M. N. Ltd., a foreign association of France carrying business in British India has been declared by the Central Board of Revenue to be a company for the purposes of the Indian Income-Tax Act. During the year ended 31st March 1947 this association had the following income :—

	Rs.
1. Banking profit at Calcutta	25,750
2. Dividend income (gross) from a rupee company of Bombay	2,250
3. Agricultural income in the Punjab	2,000
4. Banking profit in France retained in France ...	25,000
5. Income from a landed property in South Africa not brought into British India	4,000

Prepare the company's assessment for 1947–48 and determine the tax payable.

(Income-Tax Departmental 1940)

Assessment for 1947–48.

British Indian Income :

	Rs.	Rs.
Banking profit at Calcutta ...	25,750	
Dividends gross ...	2,250	28,000
Foreign income :		
Bank profit in France ...	25,000	
Property income in Africa ...	4,000	
	29,000	
Less Statutory allowance ...	4,500	24,500
Total Income		52,500

Amount of income-tax at 5 annas	...	16,406 4 0
Amount of super tax at 2 annas (assuming that no dividend on ordinary shares has been paid)	...	6,562 8 0
		22,968 12 0
Less income-tax already collected at source on dividends	...	703 2 0
Tax payable	...	22,265 10 0

Note.—For the purpose of determining the residence of the company, its British Indian income (including the Punjab agricultural income) is Rs. 30,000. Its foreign income is only Rs. 29,000. Therefore the company is an ordinary resident, because its British Indian income is greater than its foreign income.

21. From the following information compute the company's total income for the 1947–48 assessment year :—

Profit and Loss Account for the year ended 30th June 1946.

		Rs.			Rs.
Opening Stock	...	52,400	Sale of sugar, molasses, etc.		10,58,400
Cane purchased	...	4,69,200	Closing Stock	...	76,100
Manufacturing expenses		2,56,300			
Salaries and wages	...	25,200			
Stores consumed	...	46,600			
General charges	...	8,500			
Commission and brokerage		36,400			
Interest on loan	...	9,000			
Director's fees	...	5,500			
Auditors' fees	...	700			
Taxes	...	4,300			
Bad debts and reserve for bad debts	...	29,600			
Depreciation	...	64,800			
Balance c/d.	...	1,26,000			
		11,34,500			11,34,500
Managing director's remuneration at 10%	...	12,600	Balance b/f from previous year	...	8,200
Reserve	...	75,000	Balance b/d.	...	1,26,000
Provision for Dividend		30,000			
Carry-forward	...	16,600			
		1,34,200			1,34,200

1. Rs. 10,000 on account of a liability foregone by a creditor to whom the sum was due by way of commission charged by the company in the revenue accounts of preceding years and Rs. 30,000 on account of speculation profits have been carried to a special reserve. It is claimed that speculation is not the regular business of the company.

2. Salaries and wages include Rs, 2,000 on account of company's contribution to an unrecognised provident fund.

3. General charges include (a) Rs. 500 donation to a hospital were the company's employees are treated free, (b) Rs. 1,000 subscription to the Sugar Syndicate whose object is to regulate sugar sale prices, and (c) Rs. 1,600 commission to a broker for arranging a loan for the company.

4. Commission and brokerage include Rs. 10,000 on account of secret commission disbursed through the managing director. The company is prepared to satisfy the income-tax authorities in every respect except furnishing the names of payees as such disclosure would be detrimental to its business.

5. Taxes are entirely on account of sales tax levied by the Provincial Government.

6. The amount reserved for bad debts amounts to Rs. 15,000.

7. The interest on loan has been paid to a banker of Bikaner State. The company has not deducted any tax because according to the terms of contract Made in the State the creditor is entitled to receive the full amount of interest without any tax deduction.

8. The depreciation allowable is Rs 55,800.

(Income-Tax Departmental 1941 adapted)

			Rs.
Profit as per Profit & Loss Account	...		1,26,000
Add Expenditure disallowed :			
Contribution to unrecognised provident fund		2,000	
Brokerage for a loan taken	...	1,600	
Secret commission	...	10,000	
Bad debts reserve	..	15,000	
Interest paid in Bikaner State	...	9,000	
Depreciation charged	...	64,800	1,02,400
Less Expenditure allowed :			2,28,400
Managing director's commission	...	12,600	
Depreciation	...	55,800	68,400
			1,60,000
Add Income omitted from the Profit & Loss Account i.e., amount foregone by a creditor	...		10,000
Taxable income from business	...		1,70,000
Capital gain	...		30,000
Total Income of the company	...		2,00,000

Note.—Speculation profit is taken to be a capital gain, since speculation is not the regular business of the company.

22. The following is the Profit & Loss Account of a company engaged in Manufacture of hosiery :—

Profit and Loss Account for the year ended 31st March 1947

		Rs			Rs.
Opening Stock	...	50,000	Sales	...	2,80,000
Yarn consumed at cost	...	74,000	Closing Stock	...	36,000
Manufacturing charges		1,16,000	Interest on securities		
Repairs	...	16,000	net)	...	1,320
Establishment	...	3,000	Other interest	...	1,180
Postage and telegrams	...	300			
Printing and stationery	...	200			
Advertising	...	4,500			
Travelling	...	3,000			

Audit	...	500	
Sundries	...	1,500	
Income-Tax	...	2,000	
Loss on sale of electric motor	...	1,000	
Depreciation of securities	...	2,500	
Goodwill written off	...	10,000	
Block Improvement Reserve		10,000	
Net Profit	...	24,000	
		3,18,500	3,18,500

After taking the following matters into account, compute the company's total income :—

1. The company has all along valued its stocks at cost. The closing stock of Rs. 36,000 has also been valued at cost. The opening stock of Rs. 50,000, if valued at cost, would have been Rs. 30,000, and indeed in the Balance Sheet on 31st March 1946 the closing stock was shown as Rs. 30,000 which was accepted for assessment purposes. As the market price of hosiery has increased considerably, the stock as on 1st April 1946 has been revalued at estimated selling price in order to avoid inflated profits being shown

2. Repairs include an amount of Rs. 12,000 being the cost of extension to buildings made in April-June 1946, the extension being used as office and godown.

3. Advertising includes Rs. 3,000 being the cost of a permanent fixture on the top of the factory building for giving demonstration by film slides of the various processes of manufacture employed in the factory

4. Sundries include Rs. 1,000 being counsel's fees for conducting an appeal before the Income-Tax Appellate Tribunal.

5. The old electric motor, whose cost was Rs. 16,000 and writtendown value Rs. 14,000 was sold during the year for Rs. 13,000; and a new motor was purchased for Rs. 20,000.

6. The admissible normal depreciation is worked out at Rs. 19,740.

(Income-Tax Departmental 1942 adapted)

Profit as per Profit & Loss Account	...		24,000
Add Expenditure disallowed :			
Overvaluation of opening stock	...	20,000	
Building extension	...	12,000	
Advertising being capital expenditure	...	3,000	
Counsel's fees	...	1,000	
Income-tax	...	2,000	
Depreciation of securities	...	2,500	
Goodwill written off	...	10,000	
Block Improvement Reserve	...	10,000	60,500
			84,500
Less Expenditure allowed :			
Normal depreciation	...	19,740	
Initial depreciation for new building at 15%	...	1,800	
Initial depreciation for electric motor	...	4,000	25,540
			58,960
Less Interest on securities			1,320
Taxable income from business	...		57,640
Interest on securities gross	...		1,920
Total Income of company	...		59,560

23. The Profit & Loss Account of a cotton mill company for the year 31st December 1946 is as follows :—

	Rs.		Rs.
Stock at the beginning of the year	9,00,000	Sale of cloth, yarn and waste	40,00,000
Purchases of cotton, yarn, etc.	12,00,000	*Less* Reserve for selling commission	2,00,000
Coal, fuel and oil	1,20,000		38,00,000
Stores consumed	2,40,000		
Wages and salaries	6,00,000	Stock at the end of the year	14,00,000
Gross Profit	21,40,000		
	52,00,000		52,00,000
Establishment	50,000	Gross Profit	21,40,000
Mg. Director's commission	1,07,000	Sale proceeds of old accounting machines (cost Rs. 3,000) fully depreciated in 1944	4,000
Rent, Rates and Taxes	23,000		
Repairs and replacements	2,50,000		
Travelling, audit, postage and general charges	12,000	Bad debts written off in earlier years and allowed in past assessments recovered	16,000
Reserve for Taxation	2,50,000	Double income-tax relief	10,000
Law chages	13,000		
Advertising	10,000		
Printing and stationery	2,000		
Depreciation	5,65,000		
Contingency, Reserve	1,50,000		
Insurance Reserve	75,000		
Mill Improvement Reserve	2,00,000		
General Reserve	3,00,000		
Stock of cloth burnt by fire	30,000		
Net-Profit	1,33,000		
	21,70,000		21,70,000

From the above account and the subjoined information compute the company's total income for the 1947–48 assessment year :—

1. The company's articles of association provide for a reserve being made for selling commission at 5% of sales. The actual expenditure on commission is paid out of the reserve which amounted to Rs. 1,50,000 on 31st December 1945 and to Rs. 2,75,000 on 31st December 1946.

2. The stock of manufactured goods at the end of the year has been valued at market rate which was in excess of the cost by Rs. 2,00,000. The stocks of manufactured goods, raw materials, stores and stocks in process at the commencement of the year were all valued at cost which was lower than the market rate.

3. The commission of Rs. 1,07,000 paid to the managing director was in consideration of a loan of Rs. 20,00,000 advanced by him, the stipulation being that he would be entitled to a commission of 5% on gross profit subject to a minimum of 5% on the loan.

4. Rent, rates and taxes include Rs. 2,000 beinn income-tax, on staff salaries deducted from the salaries, the net salaries being shown under the head 'Establishment',

5. General charges include Diwali and mahurat expenses of Rs. 500 each.

6. Law charges include Rs. 10,000 being compromise money paid to a shareholder who threatened to bring a suit against the managing director for

appropriating a large part of the company's profit by way of commission on gross profit.

7. Advertising represents five years' charges for the years 1946 to 1950 paid to a newspaper.

8. There was no insurance cover for the stock burnt. The stock was purchased in the year 1945, but the cost is not included in the purchases nor in the closing stock.

9. The insurance reserve was Rs. 1,00,000 on 31st December 1 46 as against Rs. 75,000 on 31st December 1945.

10. On 31st December 1946 the written-down values of machinery, factory buildings and non-factory buildings were Rs. 45,00,000; Rs. 9,50,000 and Rs. 1,95,000 respectively. The rates of depreciation on these assets are 10%, 5% and 2½%. *(Income-Tax Departmental 1943 adapted)*

		Rs.
Profit as per Profit and Loss Account		1,33,000
Add Expenditure not allowed :		
Reserve for selling commission	2,00,000	
Excess commission to managing director	7,000	
Excess rent, rates and taxes	2,000	
Excess Diwali and Mahurat expenses	600	
Legal charges being capital expenditure	10,000	
Excess advertising	8,000	
Stock burnt by fire	30,000	
Insurance reserve	75,000	
Taxation reserve	2,50,000	
Depreciation charged	5,65,000	
Contingency reserve	1,50,000	
Mill improvement reserve	2,00,000	
General reserve	3,00,000	17,97,600
		19,30,600
Less Expenditure allowed :		
Selling commission	75,000*	
Salaries undercharged	2,000	
Insurance expenditure	50,000*	
Depreciation allowed	5,02,375	6,29,375
		13,01,225
Less Adjustment on account of the overvaluation of closing stock		2,00,000
		11,01,225
Less Double taxation relief being income not taxable		10,000
		10,91,225
Less Capital profit of sale of accounting machines		1,000
Total income of the company		10,90.225

The capital gain of Rs. 1,000 will be totally ignored, because capital profits which do not exceed Rs. 15,000 are absolutely exempt.

The two figures marked with an asterisk above, namely, selling commission and insurance expenditure, have been arrived at as follows :—

Reserve for Selling Commission

	Rs.		Rs.
To commission actually paid during the year	75,000	By Balance b/d.	1,50,000
To Balance c/d.	2,75,000	By P. & L. Account	2,00,000
	3,50,000		3,50,000

Reserve for Insurance

	Rs.		Rs.
To Insurance actually paid during the year	50,000	By Balance b/d.	75,000
To Balance c/d.	1,00,000	By P. & L. Account	75,000
	1,50,000		1,50,000

24. The Profit & Loss Account of a company for the year ended 30th September 1946 is given below :

	Rs.		Rs.
Opening Stock ...	3,00,000	Sale of Sugar and molasses ...	21,00,000
Cane purchased, cane cess & transport ...	8,50,000	Closing Stock (after deducting Rs. 1,00,000 for estimated loss on deterioration of quality	5,00,000
Cane royalty ...	1,00,000		
Manufacturing Expenses	4,50,000		
Gross Profit ...	9,00,000		
	26,00,000		26,00,000
Establishment ...	25,000	Gross Profit ...	9,00,000
Charges general, rent, rates & taxes audit, travelling, postage, etc.	15,000		
Repairs and Replacements	85,000		
Law charges ...	15,000		
Depreciation ...	1,50,000		
Taxation Reserves ...	2,00,000		
Net Profit ...	4,10,000		
	9,00,000		9,00,000

Determine the total income of and the taxes payable by the company for the assessment year 1947-48 after taking the following information into consideration :—

1. A dividend of Rs. 2,00,000 was declared on 2nd February 1947 in respect of the profits for the year ended 30-9-1946. Section 23-A does not apply to the company.

2. Both opening and closing stocks, before deduction of the estimated loss on deterioration from the latter, are valued at cost which is lower than the market price plus excise duty applicable to the stocks.

3. The entire cane supplies were purchased from an allied company at the price fixed by Government plus a total surcharge of Rs. 50,000 to enable the allied company to meet the cost of irrigation.

4. Manufacturing expenses include excise duty Rs. 1,00,000 and a sum of Rs. 50,000 being the difference in the price of coal for the last three years decided by an order of the court in January 1947.

5. The cane royalty is payable under the terms of an agreement with the allied company to encourage cultivation of improved quality of cane.

6. Law charges include Rs. 10,000 being the cost of defending the suit in respect of the difference in the coal price referred to above and Rs. 5,000 as damage paid to a person run over and injured by the manager of the company while driving his car on his way to the office.

7. Under the articles of association of the company the interest earned on the fixed deposits in respect of the reserve and depreciation funds was to be added to these funds. Such interest amounted to Rs. 27,000.

8. The written-down values of machinery, factory buildings and non-factory buildings were Rs. 12,00,000 ; Rs. 1,00,000 and Rs. 50,000 respectively, the depreciation rates being 9%, 5% and 2½%.

(Income-Tax Departmental 1944 adapted)

			Rs.
Profit as per Profit & Loss Account		...	4,10,000
Add Expenditure not allowed :			
Undervaluation of stock ...	1,00,000		
Cane surcharge ...	50,000		
Past expenditure *re* coal ...	50,000		
Past expenditure (legal charges) ...	10,000		
Damage paid being capital expenditure	5,000		
Depreciation charged ...	1,50,000		
Taxation reserve ..	2,00,000		5,65,000
			9,75,000
Less Depreciation allowable		...	1,14,250
			8,60,750
Add Interest on fixed deposits not shown in the Profit & Loss Account		...	27,000
Total Income of the company		...	8,87,750

Income-tax on total income at 5 annas	2,77,421	14	0
Super-tax on total income at 2 annas	1,10,968	12	0
Total Tax payable	3,88,390	10	0

Note.—As the amount of dividend does not exceed 30 per cent. of the total income of the company, no additional super-tax will be payable.

25. Ingolia Inc. is a company incorporated in the U. S. A. having its head office and most of the control and management in New York. It has been declared by the Central Board of Revenue to be a company. It carries on the business of commission agents for the sale of certain machine parts of a manufacturer in the U. S. A. It has a branch in British India for which separate Balance Sheet and Profit & Loss Account are prepared, which are as follows :—

Balance Sheet on 31st December 1946

31-12-45 Rs.			Rs.	31-12-45 Rs.		Rs.
20,000	Sundry Creditors		15,000	8,000	Furniture at cost	10,000
—	Other Finance		4,000	10,000	Motor-car at cost	6,000
4,000	Depreciation Reserve		6,000		Sundry Debtors (less Reserve)	
	Due to H. O. out of last balance	6,000		25,000	Rs. 3,000	20,000
79,000	1946 profit	80,000	86,000	60,000	Cash	75,000
1,03,000			1,11,000	1,03,000		1,11,000

Depreciation reserve	...		2,000	
Reserve for taxes	...		35,000	
Reserve for bad debts	...		3,000	1,12,500
				1,92,500
Less Expenditure admissible				
Depreciation :				
Furniture normal	...	338		
Motor-car initial	...	1,200		
Motor-car normal	...	1,200	2,738	
Manager's commission	...		9,000	11,738
				1,80,762
Add Taxable profit (apart from capital profit) on the sale of motor-car			2,000	
Commission not shown in the Profit & Loss Account			2,000	4,000
British Indian income from business			...	1,84,762
Add Foreign income in excess of Rs. 4,500			...	95,500
Total Income of the company			...	2,80,262

Note. As more than half of the company's total income has been earned in British India, it is an ordinary resident of British India.

26. The following is the Profit & Loss Account of a coal company for the year ended 31st December 1945 :—

		Rs.			Rs.
Opening Stock	...	4,00,000	Sales of coal	...	20,00,000
Coal raising	...	8,00,000	Closing Stock	...	5,00,000
Salaries and Wages	...	80,000			
Royalty based on raisings		2,00,000			
Charges general	...	50,000			
Legal charges	...	10,000			
War risk insurance premium		1,000			
Brokerage	...	10,000			
Trade License	...	100			
Audit fee	...	900			
Water Board Cess (dependent on despatch of coal)		500			
Road Cess (assessed on the basis of profits)	...	300			
Workmen's compensation insurance premium	...	200			
Balance c/d.	...	9,47,000			
		25,00,000			25,00,000
Managing Agents' commission		47,350	Balance b/d.		9,47,000
Directors' fees		19,300	Interest on securities net after paying Rs. 50 bank charges		6,700
Loss on sale of investments		14,350			

Loss suffered in an Indian state from a colliery there	45,000	Bonus received from Government for increased production	10,000
Depreciation	1,00,000		
Taxation Reserve	3,00,000		
Dividend Reserve	2,00,000		
Balance to B/S.	2,37,700		
	9,63,700		9,63,700

After taking the following information into account, compute the company's total income for the financial year 1946-47 :—

1. Both opening and closing stocks, according to the company's practice, are valued at 20% below cost.

2. Charges general include (a) Rs. 25,000 being the cost of pucca protective embankment against flood ; and (b) Rs. 1,000 being the expenditure on scientific research for improving the quality of coke. The company had claimed an expenditure of Rs. 1,000 on scientific research incurred during 1944 which was disallowed in the assessment for 1945-46.

3. Legal charges represent the cost of defending a suit regarding the company's title to the mining rights in the collieries worked by the company.

4. Salaries and wages include (a) contribution of Rs. 1,000 to an approved superannuation fund, and (b) a pension of Rs. 3,000 paid out of the said fund to a retired manager.

5. Brokerage includes Rs. 5,000 for selling shares of the company.

6. Audit fees include Rs. 500 for preparing statements for E. P. T. assessment.

7. Directors' fees include Rs. 18,000 paid to a director for a trip to the U. K. to study up-to-date mining methods.

8. Rs. 40,000 recovered from bad debts (already allowed in the 1942-43 assessment) was transferred to Labour Welfare Fund.

9. Assume that the depreciation allowance in respect of all assets, except a new addition of Rs. 2,00,000 made to machinery in May 1945, is Rs. 75,000. For the new addition the normal rate is 10%. It was added on 1st January 1945.

10. The E. P. T. payable on the profits of the year 1945 is Rs. 4,00,000.

(Income-Tax Departmental 1946 adapted)

			Rs.
Profit as per Profit & Loss Account			2,37,700
Add Expenditure disallowed :			
Cost of embankment	...	25,000	
Legal charges	...	10,000	
Pension paid	...	3,000	
Brokerage for selling shares	...	5,000	
Audit fee	...	500	
Directors' fees	...	18,000	
Road cess based on profits	...	300	
Loss on sale of investments	...	14,350	
Indian State loss	...	45,000	
Depreciation charged	...	1,00,000	
Taxation reserve	...	3,00,000	
Dividend reserve	...	2,00,000	7,21,150
			9,58,850

Less Expenditure allowed :				
Depreciation :				
Normal allowance	75,000			
Normal allowance on new machinery	20,000			
Initial depreciation on new machinery	40,000			
		1,35,000		
E. P. T. ...	...	4,00,000		5,35,000
				4,23,850
Add Bad debts recovered not shown in the Profit & Loss Account ...		...		40,000
				4,63,850
Less Interest on Securities	...	...		6,700
Taxable income from business				4,57,150
Interest on securities (gross) after allowing Rs. 50 for bank commission				9,768
Total Income of the company			Rs.	4,66,918

APPENDIX A (Depreciation Rates).

The following are the principal rates of depreciation (being percentage on the written-down value) to be allowed under section 10 (2) (vi) :—

1. Buildings :—
   - (1) First class substantial buildings of selected materials (2·5%).
   - (2) Second class buildings of less substantial construction (5%).
   - (3) Third class buildidgs of construction inferior to that of second class buildings but not including purely temporary erection (7·5%).
   - (4) Purely temporary erections such as wooden structures (No rate is prescribed ; renewals will be allowed as revenue expenditure).

Note :—Double these rates will be allowed for factory building excluding offices, godowns, officers' and employees' quarters.

2. Furniture and Fittings :—
   - (1) General (6%).
   - (2) Rate for furniture and fittings used in hotels and boarding houses (9%).

3. Machinery and Plant :—
   - (1) General rate (7%). An extra allowance up to maximum of 50 per cent. of the normal allowance will be allowed by the I. T. O. where a concern claims such allowance on account of double or multiple shift working and satisfies the I. T. O. that the concern has actually worked double or multiple shifts. This extra allowance will be proportionate to the number of days during double or multiple shifts are worked.

     For the purpose of granting this extra allowance the normal number of working days throughout the year will be taken. as 300 and if, for example, a concern has worked double or multiple shifts for 100 days, the extra allowance will be 1/3rd of 50 per cent. of the normal allowance for the whole year.

     This applies to all concerns whether the general rate or any special rate applies to them, but it does not apply to an item of machinery or plant specially excepted by the letters "N. E. S. A." (meaning no extra shift allowance) being shown against it.
   - (2) Special rates to be applied, to the whole of the machinery and plant used in the following concerns :—

A.—Flour mills, rice mills, bone mills, sugar works, distilleries, ice and factories, aerating gas factories, match factories, tea factories, shoe and leather goods factories and coffee manufacturing concerns (9%).

In the case of flour mills and sugar works, replacements of rollers will be allowed as revenue expenditure.

B.—Paper and strawboard mills, shipbuilding and engineering works, iron and brass foundries, aluminium factories, electrical engineering works, motor car repairing works, galvanising works, oil

extraction factories, chemical works, soap and candle works, lime works, saw mills, tin and can making works, dyeing and bleaching works, cement works, rod mills, brick making, tile making industry, vegetable ghee factories, wire and nail making mills, iron and steel industry, and tanneries (10%).

C.—Rubber goods factories : General machinery and plant (12%) ; Moulds (40% but N. E. S. A.)

D.—Silk mills , weaving machinery (12%).

(3) Special rates to be applied to other machinery and plant :—

A.—Electric supply undertakings : (i) Electric plant machinery and boilers (10%), and (ii) Hydro-electric concerns (2·5% but N. E. S. A.)

B.—Taxtile machinery excluding silk manufacturing machinery :—

(a) Cotton woollen and worsted and carpet (10%). Jute (excluding generating plant) and ginning and pressing machinery (9%).

C.—Office machines such as typewriters, etc., surgical instruments and building contractor's machinery (15% but N. E. S. A.)

Sewing and knitting machines (15%).

Motor taxis, motor lorries, motor buses and motor tractors (25% but N. E. S. A.)

Railway sidings (7% but N. E. S. A.)

APPENDIX B

EXTRACTS FROM FINANCE ACTS

Indian Finance Act 1947

Rates of Income-tax

A—In the case of every individual, Hindu undivided family, unregistered firm and other association of persons not being a case to which paragraph B of this Part applies—

		Rate
1.	On the first Rs. 1,500 of total income	Nil.
2.	On the next Rs. 3,500 of total income	One anna in the rupee.
3.	On the next Rs. 5,000 of total income	Two annas in the rupee.
4.	On the next Rs, 5,000 of total income	Three and a half annas in the rupee.
5.	On the balance of total income	Five annas in the rupee.

Provided that—

(i) no income-tax shall be payable on a total income which, before deduction of the allowance, if any, for earned income, does not exceed Rs. 2,500 ;

(ii) The inconme-tax payable shall in no case exceed half the amount by which the total income (before deduction of the said allowance, if any, for earned income) exceed Rs. 2,500 ;

(iii) the income-tax payable on the total income as reduced by the allowance for earned income shall not exceed either—

(a) a sum bearing to half the amount by which the total income (before deduction of the allowance for earned income) exceeds Rs. 2,500 the same proportion as such reduced total income bears to the unreduced total income, or

(b) the income-tax payable on the income so reduced at the rates herein specified—

whichever is less.

B.—In the case of every company and local authority, and in every case in which under the provisions of the Indian Income-tax Act, 1922, income-tax is to be charged at the maximum rate—

	Rate
On the whole of total income	Five annas in the rupee

Rates of Super-tax

A.—In the case of every individual, Hindu undivided family, unregistered firm and other association of persons, not being a case to which any other paragraph of this Part applies—

	Rate if income wholly earned	Rate if income wholly unearned
1. On the first Rs. 25,000 of total income ...	*Nil.*	*Nil.*
2. On the next Rs. 5,000 of total income.	Two annas in the rupee.	Three annas in the rupee.
3. On the next Rs. 5,000 of total income.	Two and a half annas in the rupee.	There and a half annas in the rupee.
4. On the next Rs. 10,000 of total income.	Three annas in the rupee.	Four annas in the rupee.
5. On the next Rs. 10,000 of total income.	Four annas in the rupee.	Five annas in the rupee.
6. On the next Rs. 10,000 of total income.	Five annas in the rupee.	Six annas in the rupee.
7. On the next Rs. 10,000 of total income.	Six annas in the rupee.	Seven annas in the rupee.
8. On the next Rs. 15,000 of total income.	Seven annas in the rupee.	Eight annas in the rupee.
9. On the next Rs. 15,000 of total income,	Eight annas in the rupee.	Nine annas in the rupee.
10. On the next Rs. 15,000 of total income.	Nine annas in the rupee.	Ten annas in the rupee.
11. On the next Rs. 15,000 of total income.	Ten annas in the rupee.	Ten and a half annas in the rupee.
12. On the balance of total income.	Then and a half annas in the rupee.	Ten and a half annas in the rupee.

B.—In the case of every local authority—

	Rate
On the whole of total income	Two annas in the rupee.

C.—In the case of an association of persons being a co-operative society, other than the Sanikatta Saltowners' Society in the Bombay Presidency, for the time being registered under the Co-operative Societies Act, 1912, or under an Act of a Provincial Legislature governing the registration of co-operative societies—

	Rate
(1) On the first Rs. 25,000 of total income.	*Nil,*
(2). On the balance of total income	Two annas in the rupee.

D.—In the case of every company—

	Rate
On the whole of total income.	Two annas in the rupee.

and in addition, in respect of that part of the total income (as reduced by the amount of dividends payable at a fixed rate) which does not exceed the amount of dividends, not being dividends payable at a fixed rate, declared in British India in respect of the whole or part of the previous year for the assessment for the year ending on the 31st day of March 1948, on the amount by which such part—

	Rate
(*a*) exceeds 30 per cent., but does not exceed 40 per cent., of the total income as so reduced ...	Three annas in the rupee.

(b) exceeds 40 per cent., but does not exceed 50 per cent., of the total income as so reduced ...	Five annas in the rupee.
(c) exceeds 50 per cent. of the total income as so reduced ...	Seven annas in the rupee :

Provided that—

(i) no additional super-tax shall be payable where such part is less than or equal to, five per cent., on the capital of the company ;

(ii) where such part is more than five per cent. on the capital of the company, the additional super-tax payable shall be reduced by the amount of additional super-tax which would, but for the provisions of class *(i)* of this proviso, have been payable had such part been equal to five per cent. on the capital of the company ;

(iii) the additional super-tax shall be payable only by a company in which the public are substantially interested within the meaning of the *Explanation* to sub-section (1) of section 23 A of the Indian Income-tax Act, 1922, or a subsidiary company of such a company where the whole of the share capital of such subsidiary company is held by the parent company or by the nominees thereof.

Explantion.—For the purposes of this paragraph,—

(a) the expression "capital of the company" shall be deemed to mean the paid up share capital at the beginning of the previous year for the assessment for the year ending on the 31st day of March 1948 (other than capital entitled to a dividend at a fixed rate) plus any reserves other than depreciation reserves and reserve for bad or doubtful debts at the same date as diminished by the amount on deposit on the same date with the Central Government under section 10 of the Indian Finance Act, 1942, or se tion 2 of the Excess Profit Tax Ordinance 1943 :

(b) the expression "dividend" shall be deemed to include any distribution included in that expression as defined in clause (6A) of section 2 of the Indian Income-tax Act, 1922 and any such distribution made during the year ending on the 31st day of March 1948 shall be deemed to have been made in respect of the whole or part of the previous year ;

(c) where any portion of the profits and gains of a company is not included in its total income by reason of such portion being exempt from tax under any provision of the Indian Income-Tax Act, 1922, the capital of the company, the total amount of dividends and the amount of dividends payable at a fixed rate shall each be deemed to be proportion thereof that the total income of the company bears to its total profits and gains.

Indian Finance Act 1948.

Rates of Income-tax

A. In the case of every individual, Hindu undivided family unregistered firm and other association of persons, not being a case to which paragraph B, C or D of this Part applies—

		Rate
1.	On the first Rs. 1,500 of total income ...	Nil.
2.	On the next Rs. 3,500 of total income ...	One anna in the rupee.
3.	On the next Rs. 5,000 of total income ...	Two annas in the rupee.

4. On the next Rs. 5,000 of total income	...	Three and a half annas in the rupee.
5. On the balance of total income	...	Five annas in the rupee.

Provided that—

(i) no income-tax shall be payable on a total income which, before deduction of the allowance, if any, for earned income, does not exceed Rs. 3000 ;

(ii) the income-tax payable shall in no case exceed half the amount by which the total income (before deduction of the said allowance, if any, for earnd income) exceeds Rs. 3,000 ;

(iii) the income-tax payable on the total income as reduced by the allowance foı earned income shall not exceed either—

(a) a sum bearing to half the amount by which the total income (before deduction of the allowance for earned inoome) exceeds Rs. 3,000 the same proportion as such reduced total income, or

(b) the income-tax payable on the income so reduced at the rates herein specified,—

whichever is less.

B. In the case of every company, not being a company to which paragraph C of this Part applies—

			Rate
On the whole of total income	...	...	Five annas in the rupee.

Provided that in the case of an Indian company—

(a) where the total income, as reduced by seven annas in the rupee and by the amount, if any, exempt from income-tax, exceeds the amount of any dividends (including dividends payable at a fixed rate) declared in respect of the whole or part of the previous year for the assessment year ending on the 31st day of March, 1949, and no order has been made under sub-section (1) of section 23 A of the Indian income-tax Act, 1922, a rebate shall be allowed at the rate of one anna per rupee on the amount of such excess ;

(b) where the amount of dividends referred to in clause (a) above exceeds the total income as reduced by seven annas in the rupee and by the amount, if any, exempt from income-tax, there shall be charged on the total income an additional income-tax equal to the sum, if any, by which the aggregate amount of income-tax actually born by such excess (hereinafter referred to as "the excess dividend") falls short of the amount calculated at the rate of five annas per rupee on the excess dividends ; and

(c) the income tax payable, after deducting any rebate permissible under clause (a), but without including any additional income-tax chargeable under clause (b), shall not exceed the aggregate of—

(i) the income-tax which would have been payable under the provision of paragraph C of this Part if the total income has been Rs. 25,000 and

(ii) half the amount by which the total income exceeds Rs. 25,000.

For the purposes of clause (b) of the above proviso, the aggregate amount of income-tax actually borne by the excess dividend shall be determined as follows :—

(i) the excess dividend shall be deemed to be out of the whole or such portion of the undistributed profits of one or more year immediately preceding the previous year as would be just sufficient to cover the amount of the excess

dividend and as have not like-wise been taken into account to cover an excess dividend of a preceding year ;

(ii) such portion of the excess dividends as is deemed to be out of the undistributed profits of each of the said years shall be deemed to have borne tax,—

(a) if an order has been made under sub-section (1) of section 23A of the Indian Income-tax Act, 1922, in respect of the undistributed profits of that year at the rate of five annas in the rupee, and

(b) in respect of any other year, at the rate applicable to the total income of the company for that year reduced by the rate at which rebate, if any, was allowed on the undistributed profits.

C. In the case of every Indian company the total income of which does not exceed Rs. 25,000—

	Rate
On the whole of total income	Two and a half annas in the rupee :

Provided that where the total income, as reduced by four and a half annas in the rupee and by the amount, if any, exempt from income-tax, exceeds the amount of any dividends (including dividends payable at a fixed rate) declared in respect of the whole or part of the previous year for the assessment year ending on the 31st day of March, 1949, and no order has been made under sub-section (1) of section 23A of the Indian income-tax Act 1922 a rebate shall be allowed at the rate of half anna per rupee on the amount of such excess.

D. In the case of every local authority and in every case in which, under the provisions af the Indian Income-tax Act, 1922, income-tax is to be charged at the maximum rate—

	Rate
On the whole of total income ...	Five annas in the rupee.

Explanation.—For the purpose of this Part,—

(a) the expression "dividend" shall be deemed to include any distribution included in that expression as defined in clause (6A) of section 2 of the Indian Income-tax Act, 1922, and any such distribution made during the year ending on the 31st day of March, 1949, shall be deemed to have been made in respect of the whole or part of the previous year ;

(b) the expression "Indian company" shall have the meaning assigned to it in clause (7A) of section 2 of the in Indian Income-tax Act, 1922.

Rates of Super-tax

A. In the case of every individual, Hindu undivided family, unregistered firm and other association of persons, not being a case to which any other paragraph of this Part applies—

	Rate, if income wholly earned	Rate, if income wholly unearned
1. On the first Rs. 25,000 of total income.	Nil	Nil
2. On the next Rs. 15,000 of total income.	Two annas in the rupee.	Three annas in the rupee.
3. On the next Rs. 15,000 of total income	Three annas in the rupee.	Four and a half annas in the rupee.
4. On the next Rs. 15,000 of total income.	Five annas in the rupee.	Six annas in the rupee.

	Rate, if income wholly earned	Rate if income whole in earned
5. On the next Rs. 15,000 of total income.	Six annas in the rupee.	Seven annas in the rupee.
6. On the next Rs. 15,000 of total income.	Six and a half annas in the rupee.	Eight annas in the rupee.
7. On the next Rs. 50,000 of total income.	Seven annas in the rupee.	Nine annas in the rupee.
8. On the next Rs. 1,00,000 of total income.	Nine and a half annas in the rupee.	Nine and a half annas in the rupee.
9. On the next Rs. 1,00,000 of total income.	Ten annas in the rupee.	Ten annas in the rupee.
10. On the balance of total income	Ten and a half annas in the rupee.	Ten and a half annas in the rupee.

B. In the case of every local authority—

	Rate
On the whole of total income	Two annas in the rupee

C. In the case of an association of persons being a co-operative society, other than the Sanikatta Saltowners' Society in the Bombay Presidency, for the time being registered under the Co-operative Societies Act, 1912, or under an Act of a Provincial Legislature governing the registration of co-operative societies—

	Rate
(1) On the first Rs. 25,000 of total income	Nil
(2) On the balance of total income	Two annas in the rupee.

D. In the case of every company—

	Rate
On the whole of total income	Three annas in the rupee.

Provided that a rebate at the rate of one anna per rupee of the total income shall be allowed in the case of any company which, in respect of its profits liable to tax under the Indian Income-tax Act, 1922, for the year ending on the 31st day of March, 1949, has made the prescribed arrangements—

(a) for the declaration and payment in the Provinces of India of the dividend payable out of such profits, and

(b) for the deduction of super-tax from dividends in accordance with the provisions of sub-section (3D) or (3E) of section 18 of the said Act;

END

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